

BLACK, J.

*U.S. NOTED FOR REPLY 2/11/61*  
*Neumann & Schindler 100-1144 A*

## TRANSCRIPT OF RECORD

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Supreme Court of the United States

OCTOBER TERM [REDACTED] 1961

No. [REDACTED] 66

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ISADORE BLAU, ETC., PETITIONER,

vs.

ROBERT LEHMAN, ET AL.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

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PETITION FOR CERTIORARI FILED MARCH 14, 1961

CERTIORARI GRANTED APRIL 24, 1961

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# United States Court of Appeals

FOR THE SECOND CIRCUIT.

**ISADORE BLAU**, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

Plaintiff-Appellant-Appellee,  
against

**ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLEY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD, JOSEPH A. THOMAS**, a co-partnership, doing business under the firm name and style of **LEHMAN BROTHERS**,

Defendants-Appellees,

**JOSEPH A. THOMAS**,  
Defendant-Appellee-Appellant,  
and

**TIDE WATER ASSOCIATED OIL COMPANY**,  
Defendant-Appellee.

## Statement Under Rule 15(b).

The following are the material entries in the case:

1955

Sept. 14 Filed complaint and issued summons.

Sept. 22 Filed summons and Return.

*Statement Under Rule 15(b)*

- Oct. 3 Filed answer of Tide Water Assoc. Oil Co.  
 Nov. 15 Filed answer of defendants other than Tide Water.

1956

- May 22 Filed Stip. and Order substituting Hecht, Hadfield, Farbach & McAlpin in place of Leve, Hecht, Hadfield & McAlpin as attorneys for defendant, Tide Water Associated Oil Co.

1957

- Oct. 22 Filed plaintiff's Notice to Admit.  
 Nov. 6 Filed Stip. and Order that defendants, Lehman Bros. responses to items contained in Notice to Admit shall not be deemed a waiver, etc.  
 Nov. 15 Filed responses of defendants Lehman Bros. to plaintiff's Notice to Admit

1958

- Jan. 20 Filed Note of Issue for Trial.

1959

- Apr. 27 Before Dawson, J. Trial begun.  
 Apr. 28 Trial continued and concluded. Decision reserved.  
 May 25 Filed transcript of record proceedings of April 27, 28, 1959.  
 May 25 Filed Opinion No. 25, 158. Court decrees that Thomas is accountable to Tide Water for his proportionate share of profits of Lehman Bros. in the short-swing transactions in Tide Water stock. If parties cannot agree on figure, it will be necessary to refer this item of damages to a Special Master to take and state account.

*Statement Under Rule 15(b)*

- June 25** Filed Order and Judgment that defendant, Tide Water have judgment against defendant, Joseph A. Thomas, for sum of \$3,893.41, together with costs in sum of \$297.40. Action dismissed as to all other defendants. Dawson, J.
- July 16** Filed plaintiff's Notice of Appeal.
- July 22** Filed Notice of Cross-Appeal by defendant, Thomas.
- Aug. 24** Filed notice of certification of appeal record to USCA.

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**Complaint.**

Plaintiff, by Morris J. Levy, his attorney, complaining of the defendants, respectfully alleges as follows:

**FIRST:** Plaintiff is the owner and holder of shares of common stock of Tide Water Associated Oil Company (hereinafter referred to as "Tide Water") and brings this action on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water.

**SECOND:** Jurisdiction of this action is conferred upon this Court and arises under the provisions of Sections 16(b) and 27 of the Securities Exchange Act of 1934, 45 U.S.C.A. Sections 78p(b) and 78aa, and other relevant sections. This action is not a collusive one to confer jurisdiction of a cause upon a court of the United States of which it would not otherwise have cognizance.

**THIRD:** The sum or amount in controversy, exclusive of interest and costs, exceeds the sum of \$3,000.00.

**FOURTH:** Upon information and belief that the defendant, [199] Tide Water, is a corporation duly organized and existing under and by virtue of the laws of the State of Delaware and has a principal place of business located in the Borough of Manhattan, City and State of New York.

**FIFTH:** Upon information and belief that at all the times hereinafter mentioned Tide Water's equity securities were duly registered on the New York Stock Exchange, a National Securities Exchange, and were not and still are not exempted securities.

**SIXTH:** Upon information and belief that at all the times hereinafter mentioned the defendants, Robert Lehman, Allan S. Lehman, John Hertz, John M. Hancock, Monroe C. Gutman, Paul M. Mazur, William J. Hammer-slough, Francis A. Callery, Frederick L. Ehrman, John R. Fell, William S. Glazier, Philip H. Isles, Herman H.

### *Complaint*

Kahn, Edwin L. Kennedy, Frank J. Manheim, Paul E. Manheim, Morris Natelson, Harold J. Szold and Joseph A. Thomas were co-partners, doing business under the firm name and style of Lehman Brothers, and will hereinafter collectively be referred to as "Lehman Brothers".

SEVENTH: Upon information and belief that at all the times hereinafter mentioned the defendant, Joseph A. Thomas, was a director of Tide Water and was also a partner in the defendant firm of Lehman Brothers.

EIGHTH: Upon information and belief that at all the times hereinafter mentioned the defendants, Lehman Brothers, deputed the defendant, Joseph A. Thomas, to represent its interests as a director on the Tide Water Board of Directors, and that at all the times hereinafter mentioned the said defendant, Joseph A. Thomas, did represent the interests of the Lehman Brothers firm on the Tide Water Board of Directors.

NINTH: Upon information and belief that between on or about December 8, 1954 and March 8, 1955, a period of less than six months, the defendant, Joseph A. Thomas, by reason of his special and inside knowledge of the affairs of Tide [200] Water, advised and caused the defendants, Lehman Brothers, to purchase and sell 50,000 shares of the \$1.20 Cumulative Preferred stock of Tide Water, realizing profits thereon which did not inure to and was not recovered by Tide Water.

TENTH: Upon information and belief that the aforesaid equity securities were not acquired by defendants, Lehman Brothers or Joseph A. Thomas, in connection with any debt previously contracted.

ELEVENTH: Upon information and belief that the acts or transactions constituting the violations of the provisions of Section 16(b) of the Securities Exchange Act of 1934, herein complained of, occurred on the New York Stock Exchange, located within the territorial lim-

*Complaint*

its of the Southern District of New York and within the jurisdiction of the Southern District Court for the Southern District of New York.

**TWELFTH:** That prior to the commencement of this action and on June 29, 1955, plaintiff's attorney sent a letter to Tide Water setting forth the facts contained in this complaint and demanding that Tide Water institute suit against the defendants, Lehman Brothers and Joseph A. Thomas, to recover the profits realized by Lehman Brothers' "short-swing" transactions in Tide Water's stock. That although more than sixty (60) days have elapsed since the demand was made upon Tide Water to institute such suit, but Tide Water has failed and refused to commence such suit pursuant to the aforementioned request.

**WHEREFORE,** plaintiff respectfully demands judgment against the defendants, as follows:

1. That the defendants, Lehman Brothers and Joseph A. Thomas, jointly and severally account to defendant, Tide Water, for all profits realized by reason of Lehman Brothers' "short-swing" transactions in Tide Water's stock as hereinabove alleged and directing the said defendants, Lehman Brothers and Joseph A. Thomas, to pay over the amount of such [201] profits with interest.

2. That plaintiff be allowed the costs and disbursements of this action including a reasonable fee for his attorney.

3. That plaintiff have such other and further relief as this Court may deem proper.

**MORRIS J. LEVY**  
Attorney for Plaintiff

(Verified by Isadore Blau, September 10, 1955.)



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**Answer.**

Defendants other than Tide Water Associated Oil Company, by their attorneys Simpson Thacher & Bartlett, for their answer to the complaint herein:

1. Deny any knowledge or information thereof sufficient to form a belief as to the truth of any of the allegations contained in paragraphs "First", "Second" and "Third" of the complaint.

2. With respect to the allegations contained in paragraph "Sixth" of the complaint, deny that Allan S. Lehman was a co-partner in the firm of Lehman Brothers during any of the times mentioned in the complaint.

3. Deny each and every allegation contained in paragraphs "Eighth" and "Ninth" of the complaint.

[219] 4. Deny each and every allegation contained in paragraph "Tenth" of the complaint, except that they admit that neither Lehman Brothers nor Joseph A. Thomas ever purchased any of the securities of Tide Water Associated Oil Company in connection with any debt previously contracted.

5. Deny each and every allegation contained in paragraph "Eleventh" of the complaint.

6. Deny each and every allegation contained in paragraph "Twelfth" of the complaint, except that they admit and allege upon information and belief that defendant Tide Water Associated Oil Company received a letter dated June 29, 1955, a copy of which is annexed as Exhibit A to the answer of said defendant; that under date of August 22, 1955 the defendant Tide Water Associated Oil Company sent a letter, a copy of which is annexed as Exhibit B to said answer; that more than 60 days have elapsed since the receipt by said defendant

**Answer**

of the aforesaid letter marked Exhibit A; and that defendant Tide Water Associated Oil Company has not commenced any suit pursuant to the request of the plaintiff.

WHEREFORE, defendants other than Tide Water Associated Oil Company demand that the complaint herein be dismissed and that they be awarded the costs and disbursements of this action.

**SIMPSON THACHER & BARTLETT**

**By EDWIN WEISL**

**A member of said firm**

**Attorneys for defendants other than Tide Water  
Associated Oil Company**

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**Notice to Admit.****SIRS:**

**PLEASE TAKE NOTICE** that plaintiff, Isadore Blau, pursuant to the Federal Rules of Civil Procedure, requests the defendants, Lehman Brothers, to make the following admissions for the purpose of this action only within ten (10) days after service of this request. That each of the following statements is true:

1. That for some time prior to on or about August 5, 1954, defendant, John Hertz, was a member of the Board of Directors of the defendant, Tide Water Associated Oil Company.

2. That the defendant, John Hertz, resigned as a Director of defendant, Tide Water Associated Oil Company, on or about August 5, 1954.

3. That on or about August 5, 1954, the defendant, Joseph A. Thomas, was elected as a member of the Board of Directors of defendant, Tide Water Associated Oil Company, and has been a director of said corporation to the present time.

[235] 4. That during the periods in which the defendants, John Hertz and Joseph A. Thomas, respectively, were directors of defendant, Tide Water Associated Oil Company, the defendants, Lehman Brothers, have served Tide Water Associated Oil Company in various financial capacities and have received payments for such services.

5. That for some time prior to on or about December 6, 1954, the defendant, John M. Hancock, was a member of the Board of Directors of Jewel Tea Company, Inc.

6. That the defendant, John M. Hancock, resigned as a Director of Jewel Tea Company, Inc. on or about December 6, 1954.

*Notice to Admit*

7. That on or about December 6, 1954, the defendant, Harold J. Szold, was elected as a member of the Board of Directors of Jewel Tea Company, Inc. and has been a director of said corporation to the present time.

8. That in its Proxy Statement, dated February 25, 1955, Jewel Tea Company, Inc. made the following statement:

"\* \* \* Mr. Szold was elected a Director by the other members of the Board to fill the unexpired term of John M. Hancock, who resigned as of December 6, 1954 after thirty-five years of service on the Board. Mr. Szold became associated with Lehman Brothers in 1924 and has been a partner of the firm since 1941."

9. That during the periods in which the defendants, John M. Hancock and Harold J. Szold, respectively, were directors of Jewel Tea Company, Inc., the defendants, Lehman Brothers, have served said corporation in various financial capacities and have received payments for such services.

10. That for some time prior to his death in the latter part of 1956, the defendant, John M. Hancock, was a member of the Board of Directors of The International Silver Company.

11. That on or about February 27, 1957, the defendant, Frank J. Manheim, was elected as a member of the Board of Directors of The International Silver Company and has been a director of said corporation to the present time.

[236] 12. That in its Proxy Statement, dated March 14, 1957, The International Silver Company made the following statement:

*Notice to Admit*

“ \* \* \* The persons mentioned in the following table \* \* \* constitute the present Board of Directors elected by the stockholders last year except for Messrs. Frank J. Manheim and Ernest S. Wilson who were elected Directors by the Board in February, 1957, to fill the vacancies created by the deaths of Messrs. Evarts C. Stevens and John M. Hancock. During the last five years Frank J. Manheim has been a partner in the firm of Lehman Brothers \* \* \* ”.

13. That during the periods in which the defendants, John M. Hancock and Frank J. Manheim, respectively, were directors of The International Silver Company, the defendants, Lehman Brothers, have served said corporation in various financial capacities and have received payments for such services.

14. That for some time prior to on or about December 30, 1952, the defendant, Robert Lehman, was a member of the Board of Directors of General Cigar Company, Inc.

15. That the defendant, Robert Lehman, resigned as a Director of General Cigar Company, Inc. on or about December 30, 1952.

16. That on or about December 30, 1952, the defendant, Harold J. Szold, was elected as a member of the Board of Directors of General Cigar Company, Inc. and has been a director of said corporation to the present time.

17. That in its Proxy Statement, dated March 2, 1953, General Cigar Company, Inc. made the following statement:

“H. J. Szold was elected a director of the third class of the Company on December 30, 1952 to succeed Robert Lehman for the remainder of the term of directors of that class expiring in 1954. Mr.

*Notice to Admit*

Lehman served as a director until the end of the year 1952. Both Mr. Lehman and Mr. Szold are partners of Lehman Brothers."

18. That during the periods in which the defendants, Robert Lehman and Harold J. Szold, respectively, were directors of General Cigar Company, Inc., the defendants, Lehman Brothers, have served said corporation in various financial capacities and have received payments for such services.

[237] 19. That during some part of 1950 and for some time prior thereto, the defendant, Paul M. Masur, was a member of the Board of Directors of The Dayton Rubber Company.

20. That during some part of 1950, after defendant, Paul M. Masur, had ceased being a director of The Dayton Rubber Company, the defendant, Herman H. Kahn, was elected as a member of the Board of Directors of said corporation and has continued as such director continuously to the present time.

21. That during the periods in which the defendants, Paul M. Masur and Herman H. Kahn, respectively, were directors of The Dayton Rubber Company, the defendants, Lehman Brothers, have served said corporation in various financial capacities and have received payments for such services.

22. That during some part of 1954 and for some time prior thereto, the defendant, John Hertz, was a member of the Board of Directors of Consolidated Vultee Aircraft Corporation.

23. That in or about May, 1954, Consolidated Vultee Aircraft Corporation was merged into General Dynamics Corporation.

*Notice to Admit*

24. That following this merger, and after defendant, John Hertz, had ceased being a member of the Board of Directors of Consolidated Vultee Aircraft Corporation and/or General Dynamics Corporation, Gordon Dean, an Associate of Lehman Brothers was elected to the Board of General Dynamics Corporation and served as such director until on or about April 25, 1957 at which time Dorsey Richardson, an Associate of Lehman Brothers was elected as a director of said corporation and is presently serving as such director.

25. That during the periods in which the defendant, John Hertz, and Messrs. Dean and Richardson were directors of either Consolidated Vultee Aircraft Corporation and/or General Dynamics Corporation, the defendants, Lehman Brothers, have served said corporations in various financial capacities and have received payments for such services.

[238] 26. That until on or about April 20, 1953 and for some time prior thereto, the defendant, John M. Hancock, was a member of the Board of Directors of The Brunswick-Balke-Collender Company.

27. That on or about April 20, 1953, the defendant, Harold J. Szold, was elected as a member of the Board of Directors of The Brunswick-Balke-Collender Company and has been a director of said corporation to the present time.

28. That during the periods in which the defendants, John M. Hancock and Harold J. Szold, respectively, were directors of The Brunswick-Balke-Collender Company the defendants, Lehman Brothers, have served said corporation in various financial capacities and have received payments for such services.

29. That until on or about January 19, 1956 and for some time prior thereto, the defendant, John M. Hancock,



*Notice to Admit*

was a member of the Board of Directors of Underwood Corporation.

30. That on or about January 19, 1956, the defendant, Joseph A. Thomas, was elected as a director of Underwood Corporation and has served as such director to the present time.

31. That during the periods in which the defendants, John M. Hancock and Joseph A. Thomas, respectively, were directors of Underwood Corporation, the defendants, Lehman Brothers, have served the said corporation in various financial capacities and have received payments therefor.

32. That for some time prior to the date of his death in the latter part of 1956, the defendant, John M. Hancock, was a member of the Board of Directors of Van Raalte Company, Inc.

33. That following the death of defendant, John M. Hancock, the defendant, Joseph A. Thomas, was elected to the Board of Directors of Van Raalte Company, Inc. and has served as such director to the present time.

34. That in its Proxy Statement, dated March 28, 1957, Van Raalte Company, Inc. made the following statement:

[239] "During 1956 three vacancies in the Board were created by the deaths of John M. Hancock and John R. Simpson and the retirement of Sidney J. Weinberg. Their places on the Board of Directors were filled by the interim election of John Fiske, Joseph A. Thomas and John L. Weinberg. During the past five years \* \* \* Mr. Thomas' principal occupation has been a Partner of Lehman Brothers \* \* \*".

35. That during the periods in which the defendants, John M. Hancock and Joseph A. Thomas, respectively,



*Notice to Admit*

were directors of Van Raalte Company, Inc., the defendants, Lehman Brothers, have served the said corporation in various financial capacities and have received payments for such services.

36. That for some time prior to the date of his death in the latter part of 1952, the defendant, Allan S. Lehman, was a member of the Board of Directors of Studebaker-Packard Corporation.

37. That following the death of defendant, Allan S. Lehman, and on or about December 19, 1952, the defendant, John Hertz, was elected as a member of the Board of Directors of Studebaker-Packard Corporation and served as such director until on or about May 20, 1955.

38. That on or about May 20, 1955, the defendant, Frank J. Manheim, was elected as a member of the Board of Directors of Studebaker-Packard Corporation and has been such director to the present time.

39. That during the periods in which the defendants, Allan S. Lehman, John Hertz and Frank J. Manheim, respectively, were directors of Studebaker-Packard Corporation, the defendants, Lehman Brothers, have served said corporation in various financial capacities and have received payments for such services.

40. That on December 8, 1954, the defendants, Lehman Brothers, converted 50,000 shares of the common stock of Tide Water Associated Oil Company into 50,000 shares of its \$1.20 Cumulative Preferred stock.

[240] 41. That on December 8, 1954, the market range of the common stock of Tide Water Associated Oil Company was a low of \$25 $\frac{1}{4}$  per share and a high of \$25 $\frac{7}{8}$  per share.

42. That between December 9, 1954 and March 8, 1955, inclusive, the defendants, Lehman Brothers, sold 50,000

*Notice to Admit*

shares of its \$1.20 Cumulative Preferred stock of Tide Water Associated Oil Company realizing net proceeds therefrom in the sum of \$1,361,186.77.

Dated: New York, New York; October 21, 1957.

Yours, etc.

**MORRIS J. LEVY**  
Attorney for plaintiff

To:

Simpson, Thacher & Bartlett, Esqs.

Attorneys for defts, other than Tide Water Associated Oil Co.

Hecht, Hadfield, Farbach & McAlpin, Esqs.

Attorneys for defendant, Tide Water Associated Oil Company

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**Responses of Defendants Lehman Brothers to Plaintiff's  
Notice to Admit.**

Defendants Lehman Brothers, for their responses to the items contained in plaintiff's Notice to Admit dated October 21, 1957, without admitting the relevancy or materiality of any of the admissions contained herein, and reserving their rights at any and all times during the pendency of this action, including the trial thereof, to object to the admission in evidence of any or all of such responses upon the ground that they or any of them is irrelevant or immaterial to any of the issues in this action.

1. Admit the statements contained in Items 1, 2, 3, 5, 6, 7, 10, 11, 14, 15, 16, 19, 20, 22, 23, 26, 27, 29, 30, 32, 33, 38, 40, 41 and 42 of said Notice to Admit.

2. Deny the statement contained in Item 4 of said Notice to Admit, except that they admit that on one occasion in 1945 while defendant John Hertz was a director of defendant Tide Water Associated Oil Company, and on another occasion in 1956 while defendant Joseph A. Thomas was a director of said defendant Company, defendants Lehman Brothers participated with others as underwriters of certain securities of said defendant Company and on each such occasion were paid a commission for such services; and that [245] on one occasion in 1940 while defendant John Hertz was a director of said defendant Company, defendants Lehman Brothers received a commission for services rendered in connection with a private placement of certain securities of said defendant Company.

3. Admit that Jewel Tea Company, Inc. issued a Proxy Statement dated February 25, 1955, but deny that the statement contained in Item 8 of said Notice to Admit constitutes the entire Proxy Statement.

*Responses of Defendants Lehman Brothers to Plaintiff's  
Notice to Admit*

4. Deny the statement contained in Item 9 of said Notice to Admit, except that they admit that on three occasions in 1941, 1947 and 1953 respectively, while defendant John M. Hancock was a director of Jewel Tea Company, Inc., defendants Lehman Brothers participated with others as underwriters of certain securities of said Company and on each such occasion were paid a commission for such services; that on one occasion in 1951 while defendant John M. Hancock was a director of Jewel Tea Company, Inc., defendants Lehman Brothers received a fee for services rendered in connection with a private placement of certain securities of said Company, and that in 1951 defendants Lehman Brothers received a fee from said Company for other services rendered in connection with financial matters.

5. Admit that International Silver Company issued a Proxy Statement dated March 14, 1957, but deny that the statement contained in Item 12 of said Notice to Admit constitutes the entire Proxy Statement.

6. Deny the statement contained in Item 13 of said Notice to Admit, except that they admit that on one occasion in 1955 while defendant John M. Hancock was a [246] director of International Silver Company, defendants Lehman Brothers received a fee from said Company for services rendered in connection with financial matters.

7. Admit that General Cigar Company, Inc. issued a Proxy Statement dated March 2, 1953, but deny that the statement contained in Item 17 of said Notice to Admit constitutes the entire Proxy Statement.

8. Deny the statement contained in Item 18 of said Notice to Admit, except that they admit that on one occasion in 1929, while defendant Robert Lehman was a director of General Cigar Company, Inc., defendants Leh-

*Responses of Defendants Lehman Brothers to Plaintiff's  
Notice to Admit*

man Brothers participated with others as underwriters of certain securities of said Company and were paid a commission for such services; that on one occasion in 1948 while defendant Robert Lehman was a director of said Company, defendants Lehman Brothers received a commission for services rendered in connection with a private placement of certain securities of said Company, and that in 1957, while defendant Harold J. Szold was a director of said Company, defendants Lehman Brothers received a fee for services rendered in connection with a reclassification of certain of the capital stock of said Company.

9. Deny the statement contained in Item 21 of said Notice to Admit, except that they admit that on three occasions in 1952, 1955 and 1957 respectively, while defendant Herman H. Kahn was a director of Dayton Rubber Company, defendants Lehman Brothers participated with others as underwriters of certain securities of said Company and on each such occasion were paid a commission for such services; that on one occasion in 1950 while [247] defendant Herman H. Kahn was a director of said Company, defendants Lehman Brothers received a commission for services rendered in connection with a private placement of certain securities of said Company; and that during the period in which defendant Paul M. Mazur was and defendant Herman H. Kahn has been a director of said Company, and prior thereto, defendants Lehman Brothers received an annual fee from said Company for services rendered in connection with financial matters.

10. Deny the statement contained in Item 24 of said Notice to Admit, except that they admit that, after the merger of Consolidated Vultee Aircraft Corporation into General Dynamics Corporation, Gordon Dean, a part-time consultant of Lehman Brothers, was elected to the

*Responses of Defendants Lehman Brothers to Plaintiff's  
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Board of Directors of General Dynamics Corporation and served as a director thereof until on or about April 25, 1957, and that on or about April 25, 1957, Dorsey Richardson, an employee of Lehman Brothers, was elected a director of said Corporation and is presently serving as such.

11. Deny the statement contained in Item 25 of said Notice to Admit, except that they admit that on one occasion in 1955, while the aforesaid Gordon Dean was a director of General Dynamics Corporation, defendants Lehman Brothers participated with others as underwriters of certain securities of said Corporation and were paid a commission for such services.

12. Deny the statement contained in Item 28 of said Notice to Admit, except that they admit that on one occasion in 1957, while defendant Harold J. Szold was a director of Brunswick-Balke-Collender Company, defendants [248] Lehman Brothers participated with others as underwriters of certain securities of said Company and were paid a commission for such services.

13. Deny the statement contained in Item 31 of said Notice to Admit, except that they admit that on one occasion in 1956, while defendant Joseph A. Thomas was a director of Underwood Corporation, defendants Lehman Brothers participated with others as underwriters of certain securities of said Corporation and were paid a commission for such services.

14. Admit that Van Raalte Company, Inc. issued a Proxy Statement dated March 28, 1957, but deny that the statement contained in Item 34 of said Notice to Admit constitutes the entire Proxy Statement.

15. Deny the statement contained in Item 35 of said Notice to Admit, except that they admit that on one

*Responses of Defendants Lehman Brothers to Plaintiff's  
Notice to Admit*

occasion in 1956, while defendant John M. Hancock was a director of Van Raalte Company, Inc., defendants Lehman Brothers received a commission for services rendered in connection with a private placement of certain securities of said Company.

16. Deny the statement contained in Items 36 and 37 of said Notice to Admit, except that they admit that Allan S. Lehman died on or about November 10, 1952, that for some time prior to his death he had been a member of the Board of Directors of Studebaker Corporation, that on or about December 19, 1952 defendant John Hertz was elected a member of the Board of Directors of Studebaker Corporation and served as such until October 1, 1954, and that thereafter defendant John Hertz became a member of [249] the Board of Directors of Studebaker-Packard Corporation and served as such until on or about May 20, 1955.

17. Deny the statement contained in Item 39 of said Notice to Admit.

Dated: New York, New York, November 14, 1957

**LEHMAN BROTHERS**

By **HERMAN H. KAHN**

A Member of the Firm

**Simpson Thacher & Bartlett**

Attorneys for Defendants other than

Tide Water Associated Oil Company

By **Stephen P. Duggan, Jr.**

A Member of the Firm

(Verified by Herman H. Kahn, November 14, 1957.)



[1]

**Transcript.****Before:****Hon. Archie O. Dawson, District Judge.****New York, April 27, 1959,  
10:30 o'clock a. m.**

[2]

**Appearances:**[3] **The Court:** Plaintiff may proceed.

**Mr. Levy:** If your Honor please, I don't know whether you would wish an opening statement in this case or whether you are familiar with the facts.

**The Court:** I have read the defendants' trial brief which was submitted last week. I haven't had time to read yours which you just handed me, but I think I have a pretty good idea from the pleadings and the trial brief I read as to what the general issue in the case is.

**Mr. Levy:** May I make a brief opening statement?

**The Court:** Surely.

**Mr. Levy:** This is an action brought by the plaintiff, a stockholder of Tidewater Associated Oil Company, for its benefit pursuant to Section 16 (b) of the Securities and Exchange Act of 1934. The action is against Joseph Thomas, a director of Tidewater, and the members of his partnership, Lehman Brothers.

With a six-month period in 1954 and 1955 Lehman Brothers converted 50,000 shares of Tidewater common stock, receiving in exchange therefor 50,000 shares of its preferred stock, and within a period of less than six months thereafter Lehman Brothers sold 50,000 shares [4] of Tidewater preferred stock, and it is plaintiff's contention that there was a profit realized in the sum of approximately \$100,000.



*Transcript*

It is further plaintiff's contention that by reason of the fact that Joseph Thomas was a director of Tidewater and also a general partner in Lehman Brothers he gave facts concerning the Tidewater business, the Tidewater policies to the members of his firm and that pursuant to statute they, meaning Lehman Brothers, are a person within the meaning of Section 16 (b) and, therefore, collectively were directors of Tidewater and subject to liability under the statute.

We will prove these facts. We will prove that Mr. Thomas told certain of his partners prior to the purchase of the Tidewater stock of the business and the business policies of Tidewater—

The Court: Does that make any difference under this statute?

Mr. Levy: Well, under Judge Learned Hand's opinion in the case of *Rattner* against *Lehman*—

The Court: Which was merely a concurring opinion.

Mr. Levy: That's right. It might make a difference. We will prove these matters before your [5] Honor and show that the inside information that Joseph Thomas gleaned as a director was imparted to the members of his general partnership and that there cannot be any cleavage between himself as a director and a general partner, and that his acts, in view of the fact that they were in a business of providing financing for Tidewater as well as other corporations, were the acts of the partnership.

The Court: Would that state of facts, exclusive of the statute, give a right of recovery?

Mr. Levy: I believe so, your Honor.

The Court: Were you relying purely on Section 16 (b) or are you relying on some other part of the law?

Mr. Levy: I am relying upon that, Section 16 (b), and opinions expressed by the Securities and Exchange Commission, in the case of *Rattner v. Lehman*—

*Transcript*

The Court: You are bringing your action merely under the statute?

Mr. Levy: That's right, sir.

The Court: All right.

Mr. Levy: Now, firstly, your Honor, I would like to amend the title of the action, since I have been [6] informed that following the commencement of this suit the name of the defendant Tidewater Associated Oil Company was changed, on May 3, 1956, to Tidewater Oil Company, and I so move, your Honor.

The Court: All right. I take it that there is no objection to that.

Mr. Hays: No objection.

Mr. Levy: I ask the defendants' counsel to stipulate that Isadore Blau is and has been a stockholder of Tidewater Oil Company during all times prior to the commencement of this action and up to the present time.

Mr. Vance: I so stipulate.

The Court: All right.

Mr. Levy: With your Honor's permission I should like to read from the deposition of the defendant Thomas taken June 19, 1956.

Would your Honor care to see this original?

The Court: Well, you can read both the questions and the answers. You don't have anybody to put on the witness stand to read the answers so you may as well do both.

Mr. Levy: I have nobody to put on the witness stand, your Honor.

[47] The Court: All right, you go ahead.

Mr. Vance: Your Honor, Mr. Carlson will go on the stand and read the answers, if that is all right with Mr. Levy.

Mr. Levy: Fine.

The Court: It makes it a little more realistic if you have someone asking questions and somebody else answering them.

*Transcript*

Mr. Levy: Yes.

Would the defendant stipulate that Joseph Thomas, during all the times mentioned in the complaint, was a director of Tidewater Oil Company and that he was also a general partner in Lehman Brothers?

Mr. Vance: I will so stipulate.

Mr. Levy: Will the defendants also stipulate that a demand was made upon Tidewater Oil Company to commence suit against these defendants and that Tidewater Oil Company refused to commence such suit, and that plaintiff commenced such suit following more than 60 days after such request.

Mr. Hays: We will stipulate that.

The Court: All right.

Mr. Levy: I should like to introduce, before I start reading the deposition of Joseph Thomas, [8] items 1 through 4 of plaintiff's notice to admit, and I will read each item separately.

"1. That for some time prior to or on or about August 5, 1954, defendant John Hertz was a member of the board of directors of the defendant Tidewater Associated Oil Company."

Mr. Vance: Just a minute, Mr. Levy. May I find my copy of the notice to admit first?

Mr. Levy: I am sorry.

Mr. Vance: Your Honor, I am going to have objections to some of these requests for admissions which are being read at the present time.

Would you wish me to wait until he has completed reading all four of them?

The Court: To the extent that they are admitted, why, Mr. Levy may read the admissions.

If they are not admitted, I don't see that there is any remedy that Mr. Levy has except to try to collect costs.

*Transcript*

Mr. Vance: Your Honor, we have answered and reserved our rights to object at the time of trial on the grounds of relevancy and materiality, and Mr. Levy has so stipulated with us, so we have given him admissions with respect to all of the questions propounded, [9] but we have reserved until this time the right to object.

Mr. Levy: That is so, your Honor.

The Court: All right. Mr. Levy, after that demand for admissions you better read whatever the admissions were and the objections that were made.

Mr. Levy: Item No. 2 of plaintiff's—

The Court: What happened to item No. 1?

Mr. Levy: Well, item No. 1 is admitted by the defendants, your Honor. They admit a number of other items in the same paragraph in which they state—and I am quoting—"Admit the statements contained in items 1, 2, 3, 5, 6"—and so forth, so that when I—

The Court: That is an admission that Mr. Hertz was a director?

Mr. Levy: Yes, sir.

Now, item No. 2 of plaintiff's notice to admit requested the following:

"That the defendant John Hertz resigned as a director of defendant Tidewater Associated Oil Company on or about August 5, 1954."

That is also admitted by the defendant.

Mr. Vance: Now, your Honor, with respect to both of those requests for admissions and the answers [10] thereto, we object on the grounds that they have no relevancy or materiality under the issues as framed by the pleadings in this action.

The Court: Well, I will take it for what it is worth. What was that date?

Mr. Levy: August 5, 1954.

Item No. 3 of plaintiff's notice to admit:

*Transcript*

**"That on or about August 5, 1954, the defendant Joseph A. Thomas was elected as a member of the board of directors of defendant Tidewater Associated Oil Company and has been a director of said corporation to the present time."**

**The defendants admit this item also.**

**Item No. 4 of plaintiff's notice to admit:**

**"That during the periods in which the defendants John Hertz and Joseph A. Thomas respectively were directors of defendant Tidewater Associated Oil Company, the defendants Lehman Brothers have served Tidewater Associated Oil Company in various financial capacities and have received payments for such services."**

**With respect to that item, the defendants state the following:**

**[11] They deny the statement contained in item 4 of said notice to admit except that they admit that on one occasion in 1945, while defendant John Hertz was a director of defendant Tidewater Associated Oil Company, and on another occasion in 1956 while defendant Joseph A. Thomas was a director of said defendant company, defendants Lehman Brothers participated with others as underwriters of certain securities of said defendant company, and on each such occasion were paid a commission for such services, and that on one occasion in 1940, while defendant John Hertz was a director of said defendant company, defendants Lehman Brothers received a commission for services rendered in connection with the private placement of certain securities of said defendant company.**

**Mr. Vance: Your Honor, we object to the request for admission No. 4 on the grounds that the fact that at one time or other Lehman Brothers may have rendered**

*Transcript*

financial services to Tidewater is not relevant or material to the issues in this action.

The Court: What is the relevancy to the issues in this action, Mr. Levy?

Mr. Levy: Well, your Honor, I wanted to show a preconceived design or plan which I have indicated [12] by—

The Court: Well, what difference does that make under the statute? That is why I asked you right at the beginning if you are relying on the statute. You said you were, so we are going to keep right within it.

Mr. Levy: I am relying on the statute, your Honor, and I say that a preconceived plan or scheme whereby the defendants put directors upon various corporations for the purpose of gleaning information and getting financial aid or financial business from them, is such a scheme that—

The Court: Where in the statute do you find anything about that?

Mr. Levy: The statute does not specifically—

The Court: Then it is irrelevant.

Mr. Levy, if you thought this thing out, you are either relying on the statute or you are relying on something else.

Now, if you are relying on the statute and taking that, then the rest of this is all irrelevant.

Mr. Levy: I am relying on the statute, but I am trying to show a connection here between Lehman Brothers and Joseph Thomas. I must show that [13] connection.

The Court: The only connection you need show under the statute is that he was a director of the company.

Mr. Levy: Under Judge Learned Hand's opinion—

The Court: I am not following Judge Learned Hand's opinion as being the law. He was merely expressing what he would not construe an opinion to be. He did not make the law. The law was made and passed by Congress.

Mr. Levy: That is right.

*Transcript*

Now, also, your Honor, under the case decided by Judge Medina in the Bankers case, which I have cited in my trial memorandum, and which was decided by the Court of Appeals in Washington, with respect to CAB against Lehman Brothers, apparently the fact that a defendant is a director of a corporation is material to show how the directorship is interwoven with a partnership, and I stand on the fact, your Honor, that the defendant, Joseph A. Thomas, as a director, imparted certain information to Lehman Brothers—

The Court: But you are relying merely on the statute?  
[14] Mr. Levy: Yes.

The Court: Now maybe you have a cause of action in something other than the statute but—

Mr. Levy: I am relying on the statute, your Honor, and I say that Lehman Brothers stand in the same shoes as Joseph A. Thomas, and I am trying to show a connection between Joseph A. Thomas' position as a director and his position as a general partner.

I am trying to show that they are one and the same, that Lehman Brothers cannot be disassociated from Joseph A. Thomas as a director. The partner cannot be disassociated from the director.

The Court: That is a matter of law.

Mr. Levy: Yes.

The Court: What are the facts?

Mr. Levy: I want to show that the fact that Lehman Brothers put Joseph A. Thomas on the board of Tidewater actually shows the connection where they actually got the information from Joseph A. Thomas in order to trade in the securities of Tidewater.

The Court: Is that a violation of anything in the statute?

Mr. Levy: That, in my opinion, your Honor, is a violation of the statute, because the statute says [15] that



*Transcript*

any means that is employed to violate the statute is a violation of the statute.

The Court: Where does it say that in the statute, in Section 16 (b), which I understand you are relying on?

Mr. Levy: It doesn't say that in the statute, but it has been construed by the courts, your Honor, in those very words.

The Court: Then you are not relying on the statute.

Mr. Levy: I am relying on the statute as having been construed by the courts, your Honor.

The Court: Where in the statute does it say that a director who is a member of a partnership has the same liability as a member of the partnership?

Mr. Levy: That is not stated in the statute but—

The Court: Then I will sustain the objection to this. I will sustain the objection to this admission because I cannot see that it has got anything to do with your cause of action at all.

Mr. Levy: May I ask your Honor whether or not the decisions of the courts construing this section are pertinent to this action?

[16] The Court: They certainly are. I wish you had given me your brief ahead of time like you were supposed to under the rules.

Mr. Vance: Your Honor, might I state that the decision construing this particular rule is the decision of the majority in the Rattner case where they held—

The Court: I realize that.

Mr. Levy: I refer, your Honor, to the case of *Smolowe v. Delendo Corporation*, 136 F. 2d 231, where the court stated "Indeed, it appears to have been the intention of Congress to strike down any means by which insiders, because of their special knowledge of the affairs of the corporation, or the plans of its board of directors, might realize for themselves a short swing profit."



*Transcript*

The Court: That was maybe the intention of Congress, but if they did not pass the necessary statute to carry that into effect, then there is nothing that the Court can do about it.

Mr. Levy: The court has apparently leaned over backwards—

The Court: What does the court say about extending that far, as it is your contention?

[17] Mr. Levy: That is my contention, that in the facts of this case, it extends from a director-partner to the partnership because the business of the partnership was financing, and they got the business from Tidewater, and I say that under those circumstances the partnership can be held and must be held in order not to emasculate the statute.

The Court: That is an argument that should have been addressed to Congress and not to the Court. Congress passed a very definite statute, and that statute is the one you are relying upon, as I understand it. Now, there may be some common law principle that you could have relied upon, but you are not relying upon that, apparently.

Well, all right, proceed with the next one. I can't see that what you had in that demand for the admission and that admission makes any material difference in this case. There are certain facts here which are obvious, and I don't think you get anywhere by trying to go into a lot of things which may be irrelevant.

Mr. Levy: Believe me, your Honor, if I thought they were irrelevant I would not attempt to foist them upon this court. I am not trying to waste the time of [18] this court.

*Deposition of Joseph A. Thomas*

I wish now to read from the deposition of the defendant JOSEPH A. THOMAS, at page 3, question 2.

"Q. Mr. Thomas, you were a partner in Lehman Brothers? A. Yes, I am a partner in Lehman Brothers."

Question 4:

"Q. In what business are you? A. Investment banking, generally; members also of the New York Stock Exchange and other exchanges."

Mr. Levy: Page 4, question 4:

"Q. How long have you been with Lehman Brothers, Mr. Thomas? A. Since 1930."

Question 1: page 5:

"Q. Does Lehman Brothers trade in securities on its own? A. For its own account?"

"Q. Yes. A. Yes."

"Q. Is that done very often? A. Well, there is no fixed policy about it. They do buy and sell securities for their own account as well as act as brokers."

[19] Mr. Levy: Page 6, question 3:

"Q. Prior to your having been elected as a member of the board of Tidewater was there a member of Lehman Brothers who was a director of Tidewater?"

Mr. Vance: Your Honor, I object to the question—I can't see the relevancy of it.

The Court: Overruled. Answer.

Mr. Levy: (Continuing)

"A. Sometime previous to my election in John Hertz, who was then and still is a partner of Lehman Brothers, had been a director of Tidewater."

*Deposition of Joseph A. Thomas*

Mr. Levy: Page 7, question 6:

"Q. Isn't it a fact, Mr. Thomas, that the various members of Lehman Brothers hold directorships in various corporations?"

Mr. Vance: Objection, your Honor.

The Court: Overruled.

Mr. Levy: (Continuing)

"A. Well, as individuals some of my partners are directors of various corporations, yes, but not as a function of Lehman Brothers. To elaborate, we hold directorships, by which I mean the various individuals in companies that have no connection whatever with Lehman Brothers. I happen to be a director of a ski [20] manufacturing company.

"Q. Of course, the directorships held by the various members of the partnership are held in various industrial and banking corporations, are they not?"

Mr. Vance: Your Honor, I object to that.

The Court: Overruled.

Mr. Vance: May I have a continuing objection to this line of questioning?

The Court: Yes.

Mr. Levy: (Continuing)

"A. I guess that would be the proper characterization.

"Q. As a matter of fact, Mr. Thomas, you, yourself, are a director in a number of industrial and banking corporations, are you not? A. Yes, I am."

Mr. Levy: Page 9, question 4:

"Q. Lehman Brothers has meetings, weekly meetings, of the general partners, do they not, Mr. Thomas? A. We have an informal meeting usually occurring when you get enough people there, on Mondays after lunch. It is not a formal meeting. There is no agenda or anything like that.

*Deposition of Joseph A. Thomas*

"Q. At these meetings various things are discussed.  
[21] A. Whatever seems important at the moment.

"Q. Is it customary at these meetings to discuss matters in which Lehman Brothers has an interest, financial or otherwise? A. As a firm?

"Q. Yes. A. A firm interest?

"Q. Yes. A. Yes. That would be the nature of the meeting."

Mr. Levy: Page 11, question 1:—

Mr. Vance: Just a second, Mr. Levy, before you go too fast.

I wish you would read question 5 and the answer to that which follows the questions which you just read.

Mr. Levy: Do you want to read it on cross examination? You are perfectly at liberty—

The Court: Do you want to read it right now?

Mr. Vance: Yes. (Reading)

"Q. Is it also customary at these meetings to have the directors or a director who is a member of Lehman Brothers and is also a member of a corporation in which Lehman is interested—is it the usual thing to discuss the finances of that corporation [22] with respect to the interest of Lehman Brothers in that corporation? A. Well, your question is rather involved. If I understand what you mean, it is not the policy of Lehman Brothers for directors to discuss the affairs of their companies before a lot of people who are not concerned. I think it would be most improper. A good many of these companies are competitive."

Mr. Levy: (Reading)

"Q. You have a substantial interest in Lehman Brothers, do you not, Mr. Thomas? A. Yes."

*Deposition of Joseph A. Thomas*

Mr. Levy: May I at this time request the defendants to stipulate the percentage of interest which Mr. Thomas had in Lehman Brothers at the time of these transactions?

Mr. Vance: Your Honor, this is a confidential matter. If liability should be established or if at some point your Honor feels it is proper to go into what his percentage is, of course I will be glad to make it available.

The Court: Was he a general partner?

Mr. Vance: He was a general partner, [23] your Honor.

The Court: Why do we need to go into his financial interest?

Mr. Levy: Because in *Ratner v. Lehman*—that was one case that I was the attorney for the plaintiff—we did not attempt to prove a connection between the director and Lehman Brothers, the partnership in any way except the bald statement that he was a partner, and in that case the court held that recovery may be had against the individual partner of his proportional interest in the partnership, and under the same case law, your Honor, the defendant Thomas, if not the defendants Lehman brothers, is responsible for his proportionate share of the Lehman Brothers profits, and, therefore, your Honor, it is important to know what his interest in Lehman Brothers was.

The Court: Mr. Vance, I don't know why his percentage of participation in Lehman Brothers should not be put on the record.

Mr. Vance: If your Honor deems it relevant at this point—

The Court: I think so. His percentage—I don't mean in dollars; I don't mean his financial transactions, but what was his percentage.

*Deposition of Joseph A. Thomas*

[24] Mr. Vance: All right, your Honor. I will obtain that at the luncheon recess and state it to the Court at that time, and if your Honor wishes it may be deemed taken as of this moment.

The Court: All right.

Mr. Levy: Page 13, question 1:

"Q. Who recommended you, Mr. Thomas, to be proposed upon the board of Tidewater? A. I don't know.

"Q. How did you come to be proposed on the board of Tidewater? A. Well, I was introduced to Mr. Staples, the new president of the company, and Mr. Staples and I lunched together several times, got to know one another, and after a month or two he rang me up one day and asked me if I would like to be a director, asking me if I would at the same time resign from the board of the Monterey Oil Company, which was another California oil company.

"Q. Who introduced you to Mr. Staples? A. I believe it was either John Schiff—it was either John Schiff or someone else in his firm. I think it was John Schiff. I think I met him at John Schiff's house in the country."

[25] Mr. Levy: Question 3:

"Q. Did Mr. Hertz have anything to do with"—

Mr. Vance: Would you read question 2, please?

Mr. Levy: All right. (Continuing)

"Q. John Schiff is a member of Lehman Brothers? A. No, he is a partner of Kuhn, Loeb & Company, and a personal friend of mine. I don't say that John Schiff recommended me to the board; I didn't say that.

"Q. Did Mr. Hertz have anything to do with your being proposed to the board of Tidewater? A. I don't know. Mr. Hertz called me once from California on the phone and said that Dave Staples had asked him about me, was I any good or not. I assume he replied to it affirmatively; I hope so."

*Deposition of Joseph A. Thomas*

Mr. Levy: Page 55, question 1:

"Q. Prior to your being elected a director of Tidewater, Mr. Hertz, who is a general partner of Lehman Brothers, was a director of Tidewater, was he not? A. He was.

"Q. And when he left Tidewater he knew that you were going to be proposed as a director on Tidewater's board, did he not?"

Mr. Vance: There was an objection interposed [26] at that point.

The Court: Overruled. He may answer.

Mr. Levy: There is no answer given.

Mr. Vance: Yes, there is.

Mr. Levy: (Continuing)

"A. I would have no way of knowing whether John Hertz knew if Tidewater was interested in me. I never discussed the subject with him.

"Q. You knew that Mr. Hertz was a director of Tidewater before you were appointed? A. I knew he had resigned also."

Mr. Levy: Page 61, question 2:

"Q. Did you know the members of the board of directors of Tidewater prior to your election? A. I knew all of them but two. Two I had never met.

"Q. Had you had any discussion with any members of the board of directors of Tidewater with respect to your being put on the Tidewater board prior to your election? A. I discussed the matter with John Schiff. I told him I had been invited to become a director.

"Q. Did you discuss it with any other members of the board? [27] A. Naturally, with Mr. Staples and Mr. Williams, the executive vice-president. Both of them had tendered the invitation to me.



*Deposition of Joseph A. Thomas*

"Q. And you testify it was about a month prior to your election that you discussed the matter with him? A. That is right."

Mr. Levy: Page 62, question 1:

"Q. Mr. Thomas, Mr. Hertz who was a member of your firm, of Lehman Brothers, resigned from the Tidewater board on August 5th, 1954, is that correct?"

Mr. Vance: Your Honor, the record shows that at that point counsel for Mr. Hertz interposed: "His resignation was accepted on August 5th."

Mr. Levy: (Continuing)

"A. His resignation was accepted; that is correct.

"Q. And on that date you became a director of Tidewater, is that right? A. I did.

"Q. When you had your discussion with Mr. Schiff approximately a month before that date Mr. Hertz was still a member of the Tidewater board, was he not? A. Well, his resignation had not been accepted at that time. That is right.

"Q. Do you recall when he submitted his resignation to the board? [28] A. I don't know.

"Q. Did you speak to him about his resigning from the Tidewater board, prior to his doing so? A. John Hertz is an elderly man and he has been anxious to retire more and more from being active, and I don't see him very often because he is not in the office very often. I knew that, generally speaking, he was going to get off as many boards as he could. I don't remember discussing specifically this board or that board, but I knew it applied all up and down the line.

"There was another reason for Tidewater, because Mr. Hertz was a close friend of Mr. Humphrey, the previous president of Tidewater, and Mr. Humphrey resigned from the management—I have the feeling that Mr. Hertz kind

*Deposition of Joseph A. Thomas*

of felt that the closeness there was gone, and he might as well resign."

Mr. Levy: Page 73, question 1:

"Q. You have testified that you spoke to Mr. Schiff about a month before you were elected, or appointed, as a director; is that right? A. That is to the best of my memory, yes."

Mr. Levy: Page 74, question 2:

Mr. Vance: Mr. Levy, will you read questions [29] 2, 3 and 4 on that page, or do you wish me to read it?

Mr. Levy: Well, either way.

Mr. Vance: I will be happy to.

The Court: Why don't you read it, Mr. Levy?

Mr. Levy: (Reading)

"Q. Where did your conversation with Mr. Schiff take place? A. I think it was over the telephone.

"Q. Did he call you or did you call him? A. I don't know. We are friends, you know, and play golf together, and we talk to one another."

Mr. Vance: Go ahead, Mr. Levy. Read over to the next page.

Mr. Levy: (Reading)

"Q. In any event, you got each other on the telephone, and could you tell us what he said to you and what you said to him as best you can recollect? A. I recollect I said to Mr. Schiff that I had been invited to come on the board of Tidewater, and he said, 'Well, I hope you do, because it will give me somebody to make those trips to San Francisco with.' It was a considerable conversation.

"Q. In other words, you told him that you had been invited to be on the board of directors? [30] A. Yes.

*Deposition of Joseph A. Thomas*

"Q. Did you tell Mr. Schiff who invited you? A. I believe I did; Dave Staples.

"Q. When did you speak to Dave Staples about this? A. He rang me sometime before. I can't be exactly accurate about the time.

"Q. As best as you can place it. A. Must have called me the latter part of July, or the first few days in August.

"Q. And you had a conversation with him over the telephone? A. Yes. He said he would like to have me come on the board, if I wanted to."

Mr. Vance: That is all you need to read as far as I am concerned.

Mr. Levy: (Continuing)

"Q. Did he tell you there was a vacancy open? A. Well, he told me that there would be room for me on the board. We didn't discuss it. I assumed that he was offering me a position that he had the right to offer me.

"Q. Did he tell you that Mr. Hertz was resigning from the board? A. He did, and he said with much regret, as he [31] thought Mr. Hertz was a fine man, competent, and complimentary things of that nature.

"Q. What else did he tell you, as you recall it? A. There was nothing else; it was a very short conversation. Well, there was one other thing. He said he hoped I wouldn't mind resigning from the board of Monterey, since there could be some competitive problems there.

"Q. At that time how many shares of stock did you own in Tidewater? A. I, personally?

"Q. Yes. A. I didn't own any stock in Tidewater at that time. I owned some Mission Development Corporation, which is the same thing, just a cheaper way to buy Tidewater.

"Q. At that time how many shares of stock did you own, personally, in Monterey Oil, as near as you can

*Deposition of Joseph A. Thomas*

recollect? A. I must have owned four or five thousand shares of stock."

Mr. Levy: Page 77, question 5:

"Q. Did you have a discussion with any of your partners with respect to the suggestion thrown out [32] by Mr. Staples that he wanted you on the board of Tidewater? A. Mr. Hertz was aware of the thing. I told Robert Lehman that I had been invited to be on the board. It is perfectly natural.

"Q. Could you tell us how that conversation came up? A. Originated with me. I was pleased by this offer, and Robert Lehman is a senior member of the firm, and I told him of the invitation. He congratulated me. He thought it was a compliment to me to be invited; I did, too."

Mr. Vance: Will you read the next question, please? I will read it, Mr. Levy.

"Q. Did he urge you to accept it? A. No.

"Q. Did he suggest that it might be good for you or be good for the firm if you accepted it? A. No. As I remember the conversation, he said, 'I think that is quite an honor this new management has paid you, to ask you to go on.'

"Q. During the course of the conversation, was Mr. Hertz mentioned, the fact that Mr. Hertz was leaving the board of directors of Tidewater? A. I don't think Mr. Hertz was mentioned in [33] that conversation at all."

Mr. Levy:

"Q. Do you recall any conversation with either Mr. Lehman or any other member of your firm where Mr. Hertz' name or the fact that he was leaving Tidewater's board of directors was mentioned? A. Well, not specifically. But Mr. Hertz' retirement from active partici-

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pation was mentioned a good many times. It was common talk that Mr. Hertz was getting older and he is less active, and we all knew that he would rather go back to his horse farm than spend a lot of time in his business.

"Q. And these discussions took place at your weekly get-togethers of Lehman Brothers? A. No, they were strictly informal. It was never discussed of any particular moment, other than the fact that John Hertz doesn't come around any more, he is gradually seeking retirement."

Mr. Levy: Page 15.

Mr. Vance: Page 15 of this deposition?

Mr. Levy: That's right. Question 3:

"Q. Do you recall any underwriting business that Lehman Brothers got from Tidewater?"

Mr. Vance: Objection, your Honor.

[34] The Court: Overruled.

Mr. Levy: (Continuing)

"A. We participated within the matter of the last few months in a \$50 million bond issue for Tidewater which was headed by Eastman Dillon Company. We participated with Kuhn, Loeb and Eastman Dillon."

Mr. Levy: Question 3:

"Q. You testified a little while ago—

Mr. Vance: What page, please?

Mr. Levy: I am sorry; page 16:

"Q. You testified a little while ago that Lehman Brothers has an industrial department. A. Yes.

"Q. Of what does that consist? A. That consists of about fifteen young men who are engaged primarily on investigative activities, in all industries, not confined to any one particular group."

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Mr. Levy: Page 18, question 1:

"Q. Of course, the industrial department has contact with the general partners of Lehman Brothers, do they not? A. Oh, yes, as all employees do.

"Q. And they do know which member of Lehman Brothers is on a particular board of an industrial [35] or other corporation? A. I should guess they would know the names of the directors of all the corporations, as a matter of public record."

Mr. Levy: Question 4:

"Q. Has it ever occurred, Mr. Thomas, where a young man from the industrial department would approach you with respect to ascertaining certain details of, say, Tidewater or any other company in which you were a director? A. It has happened. I would send him direct to the company, just as I would any other person. I have sent many introductions, not only to companies in which I am a director but also to companies where I am not a director."

Mr. Levy: Page 30, question 4:

"Q. In 1954 did Lehman Brothers purchase any securities from Tidewater, or of Tidewater? A. Yes. They purchased some securities; Arbitrage Department purchased—I don't know—several thousand shares."

Mr. Levy: I ask the defendants to stipulate at this time that 50,000 shares of common stock of Tidewater were purchased by Lehman Brothers.

[36] Mr. Vance: I will so stipulate, but I am going to ask you to read in from Mr. Thomas' deposition the questions and answers which relate to his knowledge with respect to the purchases, and if you don't want to read it in I am going to read it in to clarify what you have read there.

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Mr. Levy: I don't know what you are referring to, Mr. Vance. But may I continue, and if you want to—

Mr. Vance: You may, and then I will continue, if that is all right, your Honor, with Mr. Carlson on this point after Mr. Levy has finished.

Your Honor, would you read me back my stipulation there? I may have spoken a bit hastily.

(Record read.)

Mr. Vance: 50,000 shares of common stock. That's correct. That is so stipulated.

Mr. Levy: Would you also stipulate, Mr. Vance, that these 50,000 shares of Tidewater common stock were purchased by Lehman Brothers during the period commencing October 8, 1954, and ending November 15, 1954?

Mr. Vance: Let me check the schedule on that, if I might. I believe we have a schedule here.

[37] What were those dates, Mr. Levy?

Mr. Levy: October—

Mr. Vance: 8, 1954, through November 15, 1954?

Mr. Levy: That's right.

Mr. Vance: I so stipulate.

Mr. Levy: Page 41, question 1:

"Q. Which of the partners are in charge, or supervise the purchases of securities by Lehman Brothers? A. We have a so-called Portfolio Committee, of which I am not a member, consisting of about five partners. Because we are in and out all the time and someone has to be there when a decision is necessary to be made.

"I don't know, necessarily, who was there during that time. I travel a great deal, in my affairs, and this is not the type of transaction that I am ever identified with at Lehman Brothers.

"Q. Can you tell us who the members of the Portfolio Committee were in 1954, prior to the purchase and sale of



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Tidewater stock? A. It would have to be a guess, because they frequently change. But I would guess that my partner, Mr. Hammerslough, was on that committee, and Mr. Glazier was on that committee, and perhaps Mr. Gutman [38] was on that committee at that time. I am not exactly sure."

Mr. Levy: Page 43, question 5:—

Mr. Vance: Would you read question 2 through 4, please, on that page, Mr. Levy?

Mr. Levy: I want it distinctly understood I am reading it at your suggestion.

Mr. Vance: All right, sir.

Mr. Levy: Question which?

Mr. Vance: 2. I will read it:

"Q. Prior to the purchase of Tidewater common stock by Lehman Brothers, did any members of the Portfolio Committee discuss with you the advisability of purchasing the stock? A. No.

"Q. You were a director of Tidewater at the time, were you not? A. Yes.

"Q. Did you ever discuss, or did Mr. Hertz ever discuss with you the question of purchase of Tidewater stock? A. I never had any conversations with Mr. Hertz about the matter at all."

Mr. Levy: (Continuing)

[39] "Q. At the time that Lehman Brothers made the purchase of Tidewater common stock, this common stock was not convertible into preferred stock, was it? A. It was proposed to be converted under an announced plan.

"Q. Can you tell us in what manner the announcement was made, and when such announcement was made? A. It is a matter of newspaper record, that the president of the company gave an interview and there was an official release made by the company."

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Mr. Levy: Page 48, question 1:

"Q. When for the first time, Mr. Thomas, would you say that you learned that Tidewater had in mind a convertibility privilege for common stockholders? A. I can't give you the exact date but I can give you the circumstances.

"Q. I will take that. A. When my fellow director—Mr. John Schiff, again—and I lunched together, and he discussed the plan with me.

"Q. Can you give us a better date than that, than pointing out the circumstances? A. That would be in the—sometime between the date of the meeting and the middle of the month."

[40] Mr. Levy: I would like the defendants to stipulate for the record that that period indicates a period sometime between September 2, 1954, and September 15, 1954.

Mr. Vance: I think the most accurate way of putting that in is to put it in through the depositions which you have taken which pinpoint exactly when those articles appeared in the Wall Street Journal.

Mr. Levy: I am just trying not to clutter up the record as much as possible.

Mr. Vance: I don't think it will clutter up. I think it will clarify the record.

Mr. Levy: Very well. Page 44.

Mr. Vance: You are going back to page 44?

Mr. Levy: Yes. I assume you are willing to adopt the statement made by Mr. Gallantz on page 44, at the bottom of the page?

Mr. Vance: I think this appears clearly, Mr. Levy, as you well know—

The Court: Let's go on.

Mr. Vance:—in the depositions of other witnesses that you took.

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The Court: Whether he adopts it or not, it is sworn testimony.

[41] Mr. Levy: Mr. Gallantz, the attorney for Lehman Brothers, stated as follows:

"I have a copy of the Wall Street Journal of September 17, 1954, page 2, which contains an article headed 'Tidewater Oil may issue preferred for part of outstanding common.'"

I will read just the first two paragraphs although the article contains four:

"Tidewater Associated Oil Company is considering a proposal to let shareholders exchange part of their stock for a regular cash dividend paying stock. David T. Staples, President, said the board of directors at a meeting September 2, discussed informally the possibility of making available preferred stock in exchange for a portion of the outstanding common stock."

I would like to stop there, unless you wish me to read the following paragraph.

Mr. Vance: Mr. Levy, I don't care what you read. I think you just ought to put into the record all the facts which relate to this.

The Court: Go ahead, Mr. Levy, you read what you want.

Mr. Levy: Thank you. Now I go back again, [42] your Honor, to page 48 of Mr. Thomas' deposition, in which I asked him:

"Can you give us a better date than that, than pointing out the circumstances," referring to when he learned, when he first learned when—when he first learned that Tidewater had in mind a convertibility privilege for common stockholders, and the question was, question 3:

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"Q. Can you give us a better date than that, pointing out the circumstances? A. That would be sometime between the date of the meeting and the middle of the month."

Mr. Levy: And I again ask counsel for the defendants to stipulate that Mr. Thomas' meaning of the date was between September 2nd, the date of the meeting, to September 15, 1954.

Mr. Vance: I don't know what Mr. Thomas' understanding was.

The Court: All right. Well, read the deposition then.

- Mr. Levy: Question 4:

"Q. After you learned about this matter, did you discuss it with any members of the Lehman Brothers firm? [43] A. Certainly not."

Mr. Vance: Would you read question 5 there, Mr. Levy, or do you want me to read it?

Mr. Levy: Go ahead.

Mr. Vance: (Reading)

"Q. Did you deem this information confidential? A. Of course."

Mr. Levy: Page 50, question 5:

"Q. When you found out that Tidewater was planning to offer a convertibility privilege to common stockholders, did you attempt to find out whether Lehman Brothers owned any of the common stock? A. I knew what we owned. I think we had 100 shares at that time which the company had owned for a long time, so I didn't make any specific investigation. I knew what they had."

Question 2:

"Q. When for the first time did you find out that Lehman Brothers was going to convert its common stock

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into preferred stock? A. As soon as we bought the first shares. They were bought specifically for that purpose.

"Q. Who told you that? A. I don't know. Somebody around the office.

[44] "Q. There was a discussion had with respect to that? A. Well, discussion is too broad a word. I saw large purchases of Tidewater being made and quite properly I said, 'What are we going to do with this?' and they said 'We are going to convert it and sell it because it is a high grade stock and very desirable for institutional investors.' That is, if the plan was approved.

"Q. Can you recall at this time whether you spoke to a partner of Lehman Brothers with respect to that? A. I might have.

"Q. Can you refresh your recollection in any way and tell us who that partner was? A. I really couldn't. There are so many conversations going on in my firm every day that I can't remember them for a week, much less for a couple of years.

"Q. Were any memorandums made of conversations between partners with respect to specific subjects such as the Tidewater purchases and sales? A. To my knowledge, no memoranda were ever made on the subject, at least not by me."

Mr. Levy: Page 95, question 1:

[45] "Q. When for the first time did you become aware of that fact that your firm had begun to sell Tidewater preferred stock? A. As soon as the sheets go over my desk I see the sales.

"Q. And that was within one or two days after the sales? A. That is right. All the partners receive daily a list of the purchases and sales of our customers, and that follows through usually in about 24 to 48 hours. We delay in looking at it because we might be busy.

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**"Q.** But you were aware of the fact, weren't you, Mr. Thomas, that your firm was purchasing the stock for the purpose of reselling it to institutional investors? **A.** I was.

**"Q.** And that its intentions at all times were to convert the common stock into preferred and sell the preferred stock? **A.** That is right. I was."

**Mr. Levy:** Page 56 of Mr. Thomas' deposition, question 3:

**"Q.** Do you know the general practice of Lehman [46] Brothers with respect to their underwriting undertakings? **A.** Yes.

**"Q.** Can you give us a brief resume as to how it is done, what is the practice? **A.** Well, you ask a very broad question.

**"Q.** I will give you all the time you want to answer that, Mr. Thomas. **A.** Well, our practice is essentially the same pattern that is observed all over Wall Street. An individual in the firm, partner or non-partner, consults with management of the corporation concerned as to their financial needs, obligations, plans and attempts to work out a suitable deal, usually for the specific purpose of raising money. That you may take any one of the customary forms of securities, debt, debenture, preferred stock or common stock. In the process of negotiation the two parties arrive at a satisfactory price, satisfactory to each of them, and satisfactory in compensation, and you go ahead with the deal. That is oversimplifying it, but that is exactly what occurs.

**"Q.** In a situation of this kind are discussions also had with a partner who is a director on the [47] particular corporation to whom the underwriting is to be done? **A.** He is available usually because he knows more about it.



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"Q. Has it occurred with you, Mr. Thomas, with respect to Tidewater, that the general partners of Lehman Brothers have discussed with you various phases for underwriting securities for Tidewater?"

Page 59 is the answer on that:

"A. Well, I recall the conversation here shortly after the first of this year when we were contemplating this bond issue. Of course, we discussed it because it involved us taking a commitment of \$12 million. That is a matter of the entire firm, whether it is Tidewater or XYZ.

"Q. Since the time you were elected as a director of Tidewater have you discussed with the other members of the firm any underwriting commitments that you may have been intending to go into with respect to Tidewater securities? A. This one I referred to was the only one.

"Q. That is the only one? A. It is the only financing the company has done since I have been a director."

[48] Page 79, question 2:

"Q. Do you recall any conversation with either Mr. Lehman or any other member of your firm where Mr. Hertz' name or the fact that he was leaving Tidewater's board of directors was mentioned? A. Well, not specifically, but Mr. Hertz' retirement from active participation was mentioned a good many times. It was common talk that Mr. Hertz was getting older and he is less active, and we all knew that he would rather go back to his horse farm than spend a lot of time in his business."

Mr. Vance: I have no objection, Mr. Levy, but that is the second time you read it this morning.

The Court: I recognized that.

Mr. Levy: I am sorry.

Page 85, question 3:

"Q. Would it be in order to say that when there is any business connected with the oil business that your advice



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would be sought concerning it by Lehman Brothers? A. Sometimes it is. Sometimes not. We have several people that make the oil business their keen interest."

Mr. Vance: Your Honor, I object and move [49] to strike it out on the grounds that it is not relevant to this case.

The Court: I will allow it.

Mr. Levy: (Continuing)

"Q. Can you name any other partners in Lehman Brothers who know as much or practically as much about the oil business as you do?"

Mr. Vance: Same objection.

The Court: Objection sustained.

Mr. Levy: If your Honor please, the reason I am asking these questions is to show the connection that Mr. Thomas had between himself as a director and his partners, and show, by later questions, subject to connection, that he spoke to these men with respect to the business of Tidewater, and since these men were partners in Tidewater—in Lehman Brothers, there is a direct connection here.

The Court: What relevancy has that got to do with the issues pleaded in this case?

Mr. Levy: As I told you your Honor before, the issues with respect to this case is whether or not Lehman Brothers got information or could have gotten information from the director.

The Court: I don't see that you have [50] stated that that is the issue. There is nothing in Section 16(b) of the Securities and Exchange Act which relates to the imparting of confidential information. If you are proceeding on some other theory, then I would like to know it. But we have a very limited issue here, just Section 16(b) of the Securities and Exchange Act.

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Mr. Levy: I am proceeding on Section 16(b) of the Securities and Exchange Act of 1945, and I say to your Honor that the courts have strictly enforced Section 16(b), and they have gone out of their way, so to speak, to bring within its ambit any transactions which can or could be covered by it, and whereby any person or any firm could envisage a profit by short swing transactions.

The Court: Where has there ever been a case that a firm, of which a director is a member, has been held liable under Section 16(b)?

Mr. Levy: This is the first case of its kind, your Honor, except the case of *Ratner v. Lehman* and in that case no connection was attempted to be shown.

The Court: In *Ratner* they held that the statute did not allow liability to be recovered [51] against the partnership.

Mr. Levy: And in that case, your Honor, no connection was sought to be shown between the partners and the director with respect to the business of the corporation in which the director was on, and here we actually are showing that.

The Court: I sustain an objection to the question of who were the experts on the oil business in Lehman Brothers.

Mr. Levy: Page 86, question 2:—I assume, your Honor, that I don't need to ask for an exception, that I get it automatically.

The Court: You get it automatically.

Mr. Levy: (Continuing)

"Q. During your term of office as a director of Tidewater have any of your partners in Lehman Brothers ever approached you and told you that they would like certain things to be done in Tidewater to further the interests of Lehman Brothers? A. No, certainly not.

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"Q. Have they discussed the various business interests that Tidewater has and the probability of its success or the chance of profit? A. No. I have been asked from time to time [52] what I thought of the management not only by people of my own firm, but outsiders as well. But that is a common question directed at directors of most corporations.

"Q. You have been asked by certain members of your firm what you thought of management? A. Yes.

"Q. And what you thought of the policies that they were formulating? A. That is right.

"Q. And what your opinions were concerning the effect they would have upon the business? A. That"—

Mr. Vance: The objection was interposed there, at the time of the deposition, your Honor, that the question presumed that as though Mr. Thomas had been testifying to discussions of specific policies.

The Court: I will overrule the objection and let him give whatever answer he gave.

Mr. Levy: (Continuing)

"A. That question I can't answer.

"Q. I beg your pardon? A. That question I can't answer.

[53] "Q. Can't? A. Can't. I have answered in the affirmative that I have said that I thought the management was good and I thought their general objectives were first-rate.

"Q. Can you recall with whom you had those conversations? A. No, I can't.

"Q. Was it with one or more of your partners? A. It might have been.

"Q. Was it with Robert Lehman? A. No, I am sure it wasn't with Robert Lehman.

"Q. Was it with Mr. Hertz? A. No, none with Mr. Hertz.

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"Q. Mr. Gutman? A. Mr. Gutman I would unquestionably have discussed it, because he is very much interested in the oil business, generally speaking.

"Q. Did you ever have such discussions with Mr. Mazur? A. No.

"Q. Or Mr. Hancock? A. No. He has been ill practically ever since I was a director.

[54] "Q. How about Mr. Hammerslough? A. Yes, I have talked to Bill from time to time about it.

"Q. Mr. Callery? A. Yes, I should have mentioned Mr. Callery. Mr. Callery is very knowledgeable of the oil business. I should have mentioned him before.

"Q. Mr. Ehrman? A. I don't think I have ever discussed Tidewater with Mr. Ehrman.

"Q. Mr. Fell? A. Yes.

"Q. Mr. Glazier? A. No.

"Q. Mr. Isles? A. No.

"Q. Mr. Kahn? A. No.

"Q. Mr. Kennedy? A. Yes.

"Q. Mr. Manheim, Frank or Paul? A. Paul, yes; Frank, no.

"Q. Mr. Natelson? A. No.

[55] "Q. Mr. Szold? A. No.

"Q. With whom do you say you had most extensive conversations concerning these matters? Which of these gentlemen? A. Gutman, Hammerslough and Kennedy.

"Q. Were these gentlemen members of the committee of Lehman Brothers as you mentioned who selected various investment portfolios for Lehman Brothers? A. Kennedy certainly not. Mr. Gutman was at one time, and Mr. Hammerslough I think has been a member of the portfolio committee right along."

Mr. Levy: Question 7, same page:

"Q. Did you at any time discuss with any of these gentlemen the advisability of your firm, Lehman Brothers,

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purchasing stock in Tidewater? A. No, not as a firm investment. I have suggested from time to time that I thought Tidewater under the new management was an attractive investment.

"Q. You had suggested that to— A. Not only to individuals of my own firm but to a great many people on the outside, because that is my belief.

"Q. But you had suggested that to members of [56] your firm and told them that it would be a good investment for them? A. When the new management came in, my opinion was asked of what I thought of it, and after I watched them in, I expressed my opinion freely that I thought the management was first-rate, that the company would do well under that management.

"Q. Now, you say your opinion was asked about it? A. Yes.

"Q. Who asked your opinion concerning that? A. Some of the gentlemen that you mentioned.

"Q. These gentlemen? A. That ordinarily follow the oil industry. They are interested in all major oil companies.

"Q. Did you at any time during your discussions with any of these gentlemen go into the business of Tidewater specifically with respect to the profit angle, in other words, that it was a good investment for a short term investment on a long term investment? A. I never discussed that angle of the thing at all. I simply told them what I considered the long-range aspects of a new management of a going major oil company. I never discussed the operating details of this company with any of my partners."

[57] Mr. Levy: That concluded the testimony of Mr. Thomas, your Honor.

Mr. Vance: If your Honor will give me a moment, there are a few things that I want to read to clarify what Mr. Levy has already read.

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The Court: All right. Go ahead.

Mr. Vance: Mr. Carlson, will you turn to page 36 of Mr. Thomas' deposition, question 1:

"Q. Do you recall, Mr. Thomas, prior to the purchase of the common shares of Tidewater, any discussion with the members of Lehman Brothers had with respect to that purchase? A. No.

"Q. You do not recall anything? A. No.

"Q. Concerning any discussions? A. No. You are talking about the firm now?

"Q. Members of the firm. I am talking about the firm, I am talking about individuals as well. A. I understand you correctly. No.

"Q. If you talked to Mr. Hertz or you talked to someone, Mr. Lehman, that is a discussion with a member of the firm, and that is what I am trying to elicit from you. [58] A. No, we had no such discussions.

"Q. Did you personally talk to any members of the Lehman Brothers partnership with respect to the purchase? A. No.

"Q. Do you know of any members of the Lehman Brothers partnership discussing it amongst themselves when you were not present? A. Not to my knowledge.

"Q. When was the first time you knew that a purchase had been effected of Tidewater common stock? A. When I saw the sales sheets. I see the sales sheets that go through, the purchase and sales sheets of the firm.

"Q. How long after the actual purchase would you say that was? A. I usually see it the following day, if I look at it. My secretary gets it the following day."

Mr. Vance: I believe that is all, but please give me one more moment to check, your Honor.

Your Honor, there is one more item that I am eventually going to read from Mr. Thomas' deposition with respect to the waiver of any profit



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which the firm of Lehman Brothers might make in [59] connection with the purchase and sale of Tidewater securities, and I am prepared to read it in at this time.

The Court: All right.

Mr. Levy: If your Honor please, I will object to any testimony with respect to any type of waiver, supposed waiver, as being self-serving, and if there is any non-payment of profits I want that proven. I don't want a statement—

The Court: Who did he waive it to?

Mr. Vance: He waived it to his partners and to the world, and he so stated on the form fours which were filed with the—

The Court: You mean he was entitled to a certain profit but he says "I won't take it"? "Give it to my partners"?

Mr. Vance: He said, "I want no part of the transaction." He realized no profit, your Honor.

The Court: Well, I doubt very much—from a tax standpoint I should think he realized a profit and gave it away.

Mr. Vance: I don't believe so, your Honor.

The Court: I think from a legal standpoint, if he is entitled to the profit, the mere fact that he [60] said, "Well, I won't take it, give it to my partners," doesn't make any difference.

Mr. Vance: None of his money was put at risk in connection with the purchase. He had no connection at all with the transaction.

Mr. Levy: The partnership funds were.

Mr. Vance: But not his funds.

The Court: Well, I don't know what the nature of the waiver is. I thought you meant that after the transaction was all over he simply said, "Well, I won't take my share of the profits."



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Mr. Vance: No, sir. I would like to read this now. This is information which Mr. Levy listed in his deposition, and I think it should be read in at this point.

The Court: All right. Go ahead and read it.

Mr. Levy: If your Honor please, I object to that as being immaterial, irrelevant and also on the ground that it is hearsay, and objectionable on that ground.

The Court: We will see what appears.

Mr. Vance: Mr. Carlson, will you turn to page 87?

Mr. Levy: I assume it is understood that [61] I object to the reading of any questions with respect to the waiver.

The Court: You can't object until I hear the question. I can't rule on it until I know what the questions are.

Mr. Vance: I want to point out that these questions Mr. Levy himself asked of the witness.

The Court: I know. But he can still object to his own questions if he wants to. But I can't rule until I see the ball coming across the plate.

Mr. Vance: (Reading)

"Q. Mr. Thomas, I show you Plaintiff's Exhibit 1, for identification, and ask you to read the statement made at the bottom of the transactions"—

Mr. Levy: If your Honor please, I object to that as being hearsay.

The Court: Objection sustained. What is on a statement he doesn't have to read. It is a written document and speaks for itself.

Mr. Vance: This I offer in evidence, your Honor.

Mr. Levy: I object to that.

The Court: Is this part of your defense?

*Deposition of John Hertz*

Mr. Vance: This has been marked in connection [62] with Mr. Thomas' deposition as Plaintiff's Exhibit 1 for identification.

The Court: We are holding it for your part of the case then. I won't take it now.

Mr. Vance: Well, your Honor, in light of that ruling I respectfully except, and I will defer my whole life of questioning which I was going to read from that deposition until a later time.

The Court: All right.

What is your next thing?

Mr. Vance: That is all I have on Mr. Thomas' deposition, your Honor.

Mr. Levy: I should like to read at this time from a deposition taken of the defendant JOHN HERTZ on October 10, 1956. Page 112, question 1:

"Q. What is your name and address? A. John Hertz, 880 Fifth Avenue, New York. That is my New York address.

"Q. Are you a partner of Lehman Brothers?"—

Mr. Vance: Read question 2.

Mr. Levy: (Continuing)

"Q. What is your permanent residence, Mr. Hertz? A. Cary, Illinois.

"Q. Are you a partner of Lehman Brothers? [63] A. I am.

"Q. How long have you been a partner of Lehman Brothers? A. Since 1934, 22 years.

"Q. Were you ever a director of Tidewater? A. Yes.

"Q. Can you give me the dates when you first became a director and when you ceased being a director? A. It must have been during the year 1934 or 1935, and I ceased being a director—I don't remember the date—

*Deposition of John Hertz*

I would say within the last six, seven, eight or nine months, somewhere in there."

Mr. Levy: Would counsel for the defendants stipulate that Mr. Hertz ceased being a director of Tidewater on August 5, 1954?

Mr. Vance: I would stipulate that his resignation was accepted as of that date, but I believe his resignation was submitted a good deal earlier. Would you so stipulate?

Mr. Levy: I have no knowledge as to when his resignation was submitted. All I am asking you to stipulate is when did his resignation from the board of Tidewater become effective.

The Court: I take it it is August, 1954.

[64] Mr. Levy: Yes.

Page 113, question 1:

"Q. Can you state the circumstances of your becoming a director of Tidewater? A. Mr. William Humphrey was the president of Tidewater at the time. He and I had been personal friends for many, many years before that, and when he found that I had joined Lehman Brothers he asked me would I like to be a director of Tidewater and, of course, I was pleased to say yes.

"Q. Did you discuss your proposed nomination as a director with any members of Lehman Brothers at the time?"

Mr. Vance: Your Honor, I object to this. It seems to me this whole line of questioning is irrelevant.

The Court: Overruled. He can answer.

Mr. Levy: (Continuing)

"A. That was a long time ago.

"Q. Yes, I know. A. I don't remember any more. I suppose I gossiped about it.

*Deposition of John Hertz*

"Q. Prior to your election as a director of Tidewater or while you were such a director, rather, was there any other partner of Lehman Brothers ever a director of Tidewater? [65] A. Not to the best of my recollection, no.

"Q. So that at all times you were the only partner of Lehman Brothers who was a director of Tidewater? A. That is right.

"Q. I understand that Lehman Brothers has various departments which handle different phases of its business. Now, do certain of its partners handle business in a specific department? A. Well, I don't know. I am not familiar enough with the inside workings of Lehman Brothers to answer that truthfully and correctly. I am not really a banker. I came here as a salesman. I came here to bring business to Lehman Brothers, and I devoted my time to it, and you may not believe it but I have never been on any floor of this building excepting this floor, the eighth floor, where the restaurant is, and the downstairs where the cashier is. I have never been on any other floor of these buildings."

Mr. Vance: Your Honor, it seems to me this is going very far afield, and I must object.

The Court: Even though Mr. Hertz didn't get very far afield. I will allow him to answer.

Mr. Vance: May I have a continuing objection to this line of questioning?

[66] The Court: Oh, yes. Sure. What difference does it make?

Mr. Levy: (Continuing)

"Q. Would you say that your being a director of Tidewater brought business to Lehman Brothers? A. I am sure it did. It surely brought Tidewater business.

"Q. I understand that Lehman Brothers customarily has weekly meetings of its partners. Have you attended

*Deposition of John Hertz*

any of these meetings? A. Whenever I am in town I do."

Question 4:

"Q. Prior to your resignation, Mr. Hertz, when you attended meetings of Lehman Brothers, do you recall ever having any discussions with some of your partners concerning some of the affairs of Tidewater? A. Oh, I probably gossiped about it with them.

"Q. Were there also discussions with respect to other corporations of which certain of the partners were directors? A. Probably, but I don't remember them. Before I go any further, I want to tell you that I am hard of hearing, you know, and until I got this hearing aid, attending these partner meetings was just to be [67] present. Unless I sat up close I couldn't hear the talking."

Question 2:

"Q. At the time of your resignation or prior to your resignation from the board of Tidewater did you have any discussion with any of your partners concerning that fact? A. Why, I undoubtedly gossiped a little about it and told them that I was going to get through. I didn't want to work any longer.

"Q. Can you name some of the partners you gossiped with? Can you remember some of them? A. I can't remember that; there was no secret around it. Everybody knew I wanted to get out. I wanted to resign at the same time altogether.

"Q. In the course of your gossiping with your partners was there a discussion as to getting another member, one of your partners, in your place on the board of Tidewater? A. No, I just resigned and after I resigned I made some recommendations to different people whose boards I had left.

*Deposition of John Hertz*

"Q. After you resigned, as you stated, did you make any recommendations with respect to having [68] Mr. Thomas, one of your partners, come on the board of Tidewater in your place? A. Yes, I spoke to the president of the Tidewater Company in my last meeting with them and told them that I had a very smart young partner who knew much more about the oil business than I did. I didn't know anything about it, only what I heard around the boards, and suggested that they might be interested in taking him on. He asked me who it was and I gave him his name, and that is the last I had to do about it, excepting that Mr. Thomas told me that the president, Mr. Staples, had called him up.

"Q. At that time, when you recommended to Mr. Staples that Mr. Thomas be nominated a director of Tidewater, was there a discussion had between your partners as to the advisability of Mr. Thomas going on the Tidewater board? A. There might have been, but I wasn't in. I didn't hear any more about it.

"Q. You did have a discussion with Mr. Thomas, though, didn't you? A. Yes. I asked him whether he would like to go on the board, and he said he would.

"Q. Did you tell him that he could further the [69] interests of Lehman Brothers? A. No.

"Q. By being on the board of Tidewater? A. He is smart enough. I didn't have to tell him anything like that. He is a smart fellow."

Mr. Levy: Page 120, question 2:

"Q. At any time, Mr. Hertz, while you were a director of Tidewater did occasions arise when one or more of your partners or one or more of the employees of Lehman Brothers would discuss Tidewater affairs with you or secure advice with respect thereto? A. Nobody has ever had the nerve to ask my advice on any—in any company where I was sitting on the board of direc-



*Deposition of John Hertz*

tors. That just isn't done. I might have gossiped with somebody, but I don't recollect these things. Nothing of any seriousness surely."

Page 122, question 2:

"Q. Is it the practice of Lehman Brothers to have some of its partners go on boards of corporations in order to further the interests of Lehman Brothers?"

Mr. Vance: Objection, your Honor.

The Court: Overruled. He may answer.

Mr. Levy: (Continuing)

"A. Well, I surely joined Tidewater Company [70] thinking it was going to be in the interests of Lehman Brothers.

"Q. Did you recommend Mr. Thomas for the same reason? A. No, I recommended—well, I—I might have. It probably did involve that, but the main reason was that I was a large shareholder of Tidewater, a real large stockholder from the day I became a director, and for the general welfare of the company I thought a man like Thomas would do them a lot of good and do Lehman Brothers no harm."

Page 127, question 2:

"Q. I assume, Mr. Hertz, that at the time you were a director of Tidewater you were pretty familiar with its affairs. A. I attended all the meetings that I possibly could and listened carefully.

"Q. When for the first time did you find out that Tidewater intended to issue a proposal wherein the common stock would be converted into preferred stock? A. Oh, there were several discussions about the stock procedure during that time, but at the time of my resignation nothing had been done regarding it. It was still being discussed. A lot of different [71] plans of financing the new refinery and so on.



*Deposition of John Hertz*

"Q. Did you ever discuss any of these plans with any of your partners? A. Nothing in any way except maybe a gossiping way.

"Q. Well, let's take the word 'gossip.' A. Well, I—when you sit around with all these men and lunch together every day you are liable to talk about anything. I don't remember that. Nothing of any seriousness, surely, because the Tidewater Corporation was controlled by one man. He owned the majority of stock, and that is all there is to it. We tried to advise him. We tried to advise the president to the best of our ability."

Page 130, question 3:

Mr. Vance: Read question 2, please.

Mr. Levy: (Continuing)

"Q. Mr. Hertz, during your term as a director of Tidewater did it ever occur or one of your partners approach you in the course of conversation and told you that it might be advantageous to Lehman Brothers firm if certain things were done by the board of directors of Tidewater? A. Never. Nobody has on any corporations that I have ever been a director of.

[72] "Q. Were you ever asked by any of the partners of Lehman Brothers what you thought of Tidewater's management or its prospects? A. Oh, I probably gossiped about it."

Mr. Levy: Question 1, page 131:

"Q. Do you recall the substance of your gossip? A. Well, a lot of different things were gossiped about, the controlling ownership, Mr. Getty's, the fact that he and Mr. Humphrey were having some difficulties, had some difficulties; nothing that was—in which Lehman Brothers had any particular business.

*Deposition of John Hertz*

"Q. Now, particularly during the latter part of 1953 or 1954 just prior to your resigning from the board, do you recall any such discussion with any of your partners as to the management of Tidewater or its prospects? A. No, I never discussed any of that stuff with any partners. I might have talked about it but there was no discussion because we had nothing to say about it."

Mr. Levy: I am finished with Mr. Hertz' testimony.

Mr. Vance: If your Honor would give me one moment, I want to see if there are some things that [73] Mr. Levy has omitted.

In light of your Honor's ruling on some of the questions which Mr. Levy has propounded here to the witness, I ask him to turn to page 121, question 4:

"Q. Have any of the partners of Lehman Brothers ever made suggestions that some of the partners or one or more of the partners should attempt to be placed upon the board of directors of any particular corporation? A. Not to me."

Mr. Vance: Please turn to page 123, question 2:

"Q. Did you know that Lehman Brothers sometime in 1954 had purchased 50,000 shares of Tidewater common stock? A. Not until Mr. Gallantz told me.

"Q. That was the first time you had knowledge of that? A. Positive.

"Q. And there was never any discussion between your partners with respect to the purchase of Tidewater stock by Lehman Brothers? A. I never even heard a whisper of it. When I go away from here I am not likely to."

Mr. Vance: I believe that is all, your Honor.

*Deposition of William J. Hammerslough*

[74] Mr. Levy: If your Honor please, I would like to read from the deposition taken of the defendant WILLIAM J. HAMMERSLOUGH on April 10, 1957.

Page 3:

"Q. What is your full name and address? A. William J. Hammerslough, 930 Park Avenue, New York City.

"Q. Are you a partner of Lehman Brothers? A. I am."

Mr. Vance: You might as well run down to the bottom of the page.

Mr. Levy: (Reading)

"Q. How long have you been a partner? A. I think I have been a partner since 1930, about 27 years.

"Q. Were you ever a director or officer of Tidewater? A. No, never.

"Q. Does Lehman Brothers trade in securities for its own account? A. Yes."

Mr. Levy: Question 3:

"Q. Does Lehman Brothers underwrite securities for corporations, of which one or more of its partners are [75] either officers or directors?"

Mr. Vance: Objection.

The Court: Overruled.

You may answer.

"A. You mean have they done so?

"Q. Yes. A. Yes.

"Q. In such instances is Lehman Brothers a manager of the underwriting group?"

Mr. Vance: Your Honor, do I have a continuing objection to this line of questioning?

The Court: Yes. I will allow it.

"A. Oh, yes. Not in all cases, but in many cases.

*Deposition of William J. Hammerslough*

"Q. Would you say that in most of the cases where Lehman Brothers had a partner on the board of a corporation, and in which it was an underwriter, Lehman Brothers was a manager, or one of the managers, of the underwriting group? A. I couldn't answer that exactly, but there have been cases, many cases, where we have been.

"Q. It has been testified on prior examinations of your partners that Lehman Brothers customarily has weekly meetings of its members. At these meetings, has there ever been any discussion with respect to [76] having one or more of your partners seek representation on the board of directors of any corporation? A. Well, the word 'seek'—I would say this in answer to that question: When we have done, on occasion, a new issue of securities to the public, the company has sometimes asked the partnership of Lehman Brothers whether so-and-so would come on the board.

"Q. Can you expand on that, Mr. Hammerslough? When you say they have asked so-and-so, you mean one of your partners, to come on the board? A. Yes."

Mr. Levy: Page 7, question 4:

"Q. Have you ever discussed Tidewater's affairs with Mr. Thomas? A. Well, we discussed the fact that we were a—in an underwriting of Tidewater, in a bond issue, headed by Eastman, Dillon, I think it was—this latest issue of Tidewater bonds.

"Q. Did you ever have any discussions with Mr. Thomas in 1954, after he had become a director of Tidewater, concerning the affairs of Tidewater? A. I know this, that Thomas spoke very highly of the management and prospects of the Tidewater Oil [77] Company. I believe he thought very highly of it."

*Deposition of William J. Hammerslough*

Mr. Levy: Page 9, question 4:

"Q. Between October 8, 1954, and November 15, 1954, Lehman Brothers purchased 50,000 shares of the common stock of Tidewater for its own account; is that correct? A. Subject to checking the dates, yes.

"Q. Who authorized such purchase? A. I believe I authorized the purchase.

"Q. Do you have a Portfolio Committee which is in charge of authorizing purchases and sales of stock for Lehman Brothers of its own account? A. Yes, we did have at that time."

Mr. Levy: Question 4:

"Q. Now, in 1954, when Lehman Brothers purchased the 50,000 shares of Tidewater's common stock, who besides yourself were members of the Portfolio Committee?

A. As I remember it, the members of the Portfolio Committee were myself, William Glazier, a partner, and Stuart Shotwell. They were the formal members, but all other partners were invited at times to attend the meetings, and it wasn't necessarily always confined to just those three persons."

Mr. Levy: Page 12, question 1:

[78] "Q. In 1954, what were the duties of the Portfolio Committee? A. The duties?

"Q. Yes. A. Well, I would say in general that it was a sort of a watchdog of the portfolio, and if the committee came up with any ideas, they would report them and possibly take some action on them, and if they thought something was very attractive, they might buy a certain amount of it, or they might sell something."

Mr. Levy: Page 15, question 3:

"Q. Was there a discussion between members of Lehman Brothers concerning the advisability of Lehman Brothers

*Deposition of William J. Hammerslough*

purchasing 50,000 shares of Tidewater's common stock?  
A. There certainly was.

"Q. Where did this discussion take place and who attended it? A. I don't remember exactly where it took place, but it took place in our offices here, either one office or another. And to the best of my recollection Mr. Glazier was at that meeting and we invited Mr. Herman Kahn, a partner of Lehman Brothers, whose judgment we admired, to join in that discussion."

[79] Mr. Levy: Question 4:

"Q. Can you tell us what the discussion was at this meeting between yourself and Mr. Glazier and Mr. Kahn concerning the advisability of purchasing Tidewater common stock? A. Well, we both had—we, all of us, had the feeling, I believe, that this preferred stock into which the common was going to be exchanged subject to the approval of whatever the statement in the paper said, would be a very, very safe, good investment, and would be attractive, once it was issued, to institutional investors throughout the country."

Mr. Vance: Before you leave that page, Mr. Levy, I may have misunderstood you, but I believe you left out questions 2 and 3. If you did, I would like you to please read them in.

Mr. Levy: You can read them.

Mr. Vance: (Reading)

"Q. Did you at any time call Mr. Thomas in to discuss this purchase of 50,000 shares of Tidewater common stock? A. I don't recollect doing so.

"Q. Did you ever personally discuss with Mr. [80] Thomas the advisability of purchasing 50,000 shares of Tidewater stock? A. I do not recollect doing so."

*Deposition of William J. Hammerslough*

Mr. Levy: Page 17, question 3:

"Q. At this discussion among Mr. Kahn, Mr. Glazier and yourself, did you also discuss the fact that you contemplated converting these common shares of Tidewater stock into its preferred shares? A. Yes.

"Q. When issued? A. Yes."

Mr. Vance: Would you read the next question, please?

Mr. Levy: You can read it,

Mr. Vance: (Reading)

"Q. Did any one of these partners state that he had spoken to Mr. Thomas? A. No."

Mr. Levy: Page 24, question 6:

"Q. How long, Mr. Hammerslough, would you say that you and your partners, or the members of the Portfolio Committee, kicked around this idea of purchasing Tidewater stock before you actually gave this order to Mr. Levy to purchase it for you? [81] A. To the best of my recollection, not too long in time.

"Q. Well, was it one day? A. Something like that."

Mr. Levy: I have nothing further to read from Mr. Hammerslough's testimony.

Mr. Vance: If your Honor would give me a moment, I would like to check to see if there are any other questions which are required to be read.

In light of your Honor's rulings admitting certain testimony there are certain additional questions which I feel are necessary to ask here or to read here.

Would you turn to page 6, question 5:

"Q. Did you have any discussions with your partner, Joseph A. Thomas, relating to his election as a member on the board of Tidewater? A. None.



*Deposition of William J. Hammerslough*

"Q. You never spoke to anyone concerning his getting on Tidewater's board? A. I never did.

"Q. Prior to his— A. No.

"Q. Prior to his being elected? A. No."

[82] Mr. Vance: Would you turn to page 8, question 2:

"Q. A little while back we were discussing the weekly meetings of Lehman Brothers. A. Yes.

"Q. At these meetings was Mr. Thomas present? A. At every meeting?

"Q. At most of these meetings. A. I think when he was in town and available he was there, yes.

"Q. At these meetings, was there at any time a discussion of the management or business affairs of Tidewater which might be applicable to the business of Lehman Brothers? A. Not to my knowledge.

"Q. Prior to Mr. Hertz' leaving the board of directors of Tidewater, did you ever have a discussion with him concerning the affairs or management or business policies of Tidewater? A. No.

"Q. At any time did you have any discussion with any of your partners concerning the advisability of having one of them take Mr. Hertz's place on Tidewater's board? [83] A. I never did.

"Q. Do you know of any such discussion between any of your partners? A. No, I do not."

Mr. Vance: Page 13, top of the page, question 1:

"Q. When, for the first time, did the Portfolio Committee discuss the purchase by Lehman Brothers of 50,000 shares of Tidewater common stock? A. You mean when was the first time?

"Q. Yes. A. As far as I remember, there was an article—I read the Wall Street Journal very religiously when I am working here—and that has been a long time—and

*Deposition of William J. Hammerslough*

I remember that after this announcement was made that we had a discussion about this situation."

Mr. Levy: We read that before.

Mr. Vance: I don't believe it was read. I would like to read it again.

"Q. Are you referring to any specific date in the Wall Street Journal? A. I haven't got the date before me, no.

"Q. Can you tell us what the substance of that article was? [84] A. Well, to the best of my recollection it was a statement—well, it would be easy, would it not, to get the Wall Street Journal of about that particular time and show you the article, because I can't quote it word for word?

"Q. Do you recall what the substance is? I am not asking you to quote it word for word. Do you know approximately what it said? A. Well, that they were calling a meeting—this is my recollection—to discuss offering an exchange of Tidewater stock for a new \$1.20 preferred stock."

Mr. Vance: Page 20, question 2:

"Q. Mr. Hammerslough, I show you a copy of an article from the Wall Street Journal dated September 17, 1954, and I ask you whether you saw that article. A. Yes, I believe I did see that one.

"Q. Is that the article you refer to? A. I don't know. I would have to see the other article."

Mr. Vance: Mr. Levy, would you stipulate that the two articles from the Wall Street Journal which were marked as exhibits for identification are the articles referred to in Mr. Hammerslough's testimony?

[85] Mr. Levy: Yes, the articles that were marked for identification in Mr. Hammerslough's testimony are the articles referred to here.

*Deposition of William J. Hammerslough*

Mr. Vance: Would you stipulate their admission in evidence?

Mr. Levy: I don't see the relevancy of the articles themselves. I have no objection as to dates, stipulating as to the date when the articles appeared.

Mr. Vance: Well, you have referred to them yourself previously. I am merely trying to clarify the record.

Mr. Levy: If you want to put them in, you can put them in. There is no objection to that.

The Court: They will be received in evidence as Defendants' Exhibits A and B.

(Marked Defendants' Exhibits A and B, respectively, in evidence.)

[86] Mr. Vance: Page 21, question 2:

"Now, Mr. Hammerslough, I show you an article from the Wall Street Journal dated October 8, 1954, and ask you whether you saw that article. A. Oh, yes, I saw this article.

Mr. Vance: Now, if you would turn to page 29, question 3.

"Q. Has it been customary, Mr. Hammerslough, for your firm to deputize one of your partners to go on the boards of certain corporations with which you were doing business, or contemplating doing business? A. I would say no."

Mr. Vance: That is all, your Honor.

*Deposition of Monroe C. Gutman*

Mr. Levy: I should like to read from the deposition of the defendant MONROE C. GUTMAN taken on October 24, 1956, page 3:

"Q. What is your full name? A. Monroe C. Gutman.

"Q. Your address? A. 480 Park Avenue.

"Q. Are you a partner of Lehman Brothers? A. I am.

"Q. Has your firm had any business dealings with Tidewater Associated Oil Company? [87] A. I think they participated in an issue for the Tidewater Oil Company some time in the last year or so. I don't know exactly when it was."

Mr. Levy: Question 6:

"Q. Prior to this past year, have you had any business dealings with Tidewater? A. In the past we did some financing for them, I believe."

Mr. Levy: Page 5, question 4:

"Q. How long have you been with Lehman Brothers? A. I think it was about 1924. It is about right within a year or so."

Mr. Levy: Page 9:

"Q. Mr. Gutman, do the partners of Lehman Brothers have weekly meetings? A. We usually have meetings at luncheon, on Monday.

"Q. Who are present at those meetings? A. All the partners that are in New York that aren't otherwise occupied."

Mr. Levy: Page 10, question 5:

"Q. Can you tell us what happens at the meetings, at these weekly meetings, of the partners of Lehman Brothers? [88] A. Any partner that has anything that he thinks is important, from the point of view of a firm deci-

*Deposition of Monroe C. Gutman*

sion, tries to get the judgment of the other people as to what should be done."

Mr. Levy: Page 12, question 6:

"Q. How long do you know Mr. Thomas? A. For a great many years.

"Q. Have you ever discussed any of Lehman Brothers' business with him? A. I discuss Lehman Brothers, at times, with any of my partners.

"Q. Did you ever discuss any Tidewater business with him? A. No, not directly with him."

Mr. Levy: Page 14, question 6:

"Q. Who in your organization was assigned to the Tidewater financing business? A. In Tidewater financing business, it was done by Mr. Thomas. I think he was assisted by some of the staff. He probably had assistance from other partners, too. I don't know the details. As a rule, he is apt to have.

"Q. Did he discuss these matters with the other partners? [89] A. I don't remember the details, Mr. Levy, but I am sure, before undertaking a commitment for the firm to do public financing, it was discussed at a partners' meeting. Frankly, I don't remember that discussion, but I think it probably was.

"Q. Who was in charge of"—

Mr. Vance: Just a second, your Honor. I am not objecting to this line of questioning because I assume your ruling with respect to the other depositions would carry over here and that I have a continuing exception.

The Court: Yes.

Mr. Levy: (Reading)

"Q. Who is in charge of assigning one or more of the partners of Lehman Brothers to a particular piece of

*Deposition of Monroe C. Gutman*

business with a firm or corporation? A. Well, if a piece of business comes up, it usually comes to some part of the firm and is automatically handled by the person it comes to. If it comes to the firm out of a clear sky, then it is assigned, as a rule, by Mr. Robert Lehman. If it is some piece of business that we have not been familiar with before.

"Q. Is it usually assigned to that particular partner who is a director in the company? [90] A. That doesn't follow, it depends upon the type of financing; but it is very likely. He certainly would be one of those who would be consulted. He would be consulted, because he would be cognizant of what is going on.

"Q. Would such director at all times be a member of the committee handling such negotiations? A. I wouldn't want to make a statement, 'at all times.' He would be very likely to be, I think."

Mr. Levy: Question 3:

"Q. I say where Lehman Brothers' partners are directors on corporations and your firm has had financing or other business dealings with such firms, has it ever occurred, within your knowledge, that that particular director of the corporation was not in on the discussions and negotiations, except where such partner was sick? A. No, I would say that I think that has happened where the director of the corporation may be there at the very initial preliminary meeting when nothing is developed, when one or more of the younger members of the staff attend to the thing from that point on.

"Q. Let me get this clear, Mr. Gutman. Is it your testimony, then, that the director of the corporations with which Lehman Brothers has business [91] dealings usually is in on discussion, whether it be initial or throughout the negotiations? A. I think the director will certainly initially be in on the discussion; but from that point on,

*Deposition of Monroe C. Gutman*

in some cases, he will have practically nothing to do with it."

Mr. Levy: Page 19, question 1:

"Q. Mr. Gutman, does your firm have a policy of having members of your firm, or your partners, go on the various boards of directors of companies? A. We have no definitive policy. We do it at times and at times we don't."

Mr. Levy: Page 20, question 1:

"Q. In other words, when you have them go on boards, you suggest that they go on boards; is that correct? A. Not always.

"Q. There are some times when you do? A. There are times when it has been suggested; yes, that is correct."

Mr. Levy: Page 27, question 3.

Mr. Vance: Before you get to that, would you just read question 3 on page 20 from which you were just reading? Or do you want me to read it?

Mr. Levy: Yes, you read it.

[92] Mr. Vance: (Reading)

"Q. I assume the reason for that is that it benefits Lehman Brothers? A. No, sir, I don't believe it is. I think the reason for it is because we figure from the point of view for the company and the point of view for the investors."

Mr. Levy: Page 27, question 3:

"Q. Did Lehman Brothers ever make any request to any corporation with whom it had done business to have representation on its board of directors? A. I would assume that we have. I am just assuming that. I can't recall a particular instance. Certainly, over the years, it has taken place.



*Deposition of Monroe C. Gutman*

**"Q.** Have you, Mr. Gutman, personally been elected as a director of a corporation pursuant to such request made by either you or other members of your partnership? **A.** I was elected director of certain companies, way back in the twenties, at the request of Herbert Lehman, and when he went into political life and succeeded."

**Mr. Levy:** Page 29, question 2:

**"Q.** You stated that your firm did financing for Tidewater last year. Did Mr. Thomas bring that up for discussion before the members of Lehman Brothers? [93] **A.** I don't remember specifically that he did, but I think it is almost a fair assumption that he would have."

**Mr. Levy:** I have nothing further to read from the testimony of Mr. Gutman.

**Mr. Vance:** If your Honor will bear with me a moment.

Would you turn to page 14, question 1:

**"Q.** Did you ever discuss with Mr. Thomas his going on the board of the Tidewater Company? **A.** No, I haven't.

**"Q.** Did you ever discuss with any partner in Lehman Brothers the fact that Mr. Thomas was proposed for the board of Tidewater? **A.** No.

**"Q.** Have you ever heard such discussion in your presence between any partners of Lehman Brothers? **A.** I have not."

**Mr. Vance:** Page 29, question 1:

**"Q.** Within your knowledge, Mr. Gutman, has Mr. Thomas ever brought up for discussion at these meetings of your firm matters pertaining to Tidewater affairs? **A.** No, not as to the company's affairs. When it had to do with financing it would be brought up by [94] him to be discussed. As to what is going on in the company, we

*Deposition of William S. Glazier*

have a number of directors on boards. That type is not brought up for discussion."

Mr. Vance: That is all, your Honor.

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Mr. Levy: I would like to read from the deposition of the defendant WILLIAM S. GLAZIER taken on September 12, 1957.

Page 3, question 1:

"Q. Will you please state your full name and address?  
A. William S. Glazier, 127 East 80th Street, New York 21.

"Q. In what capacity are you connected with Lehman Brothers? A. I am a general partner.

"Since when have you been a general partner? A. January 1, 1940.

"Q. Do you know Mr. Thomas? A. Yes.

"Q. I understand from prior examinations of your partners that Lehman Brothers has a portfolio committee. A. That is correct.

"Q. In 1954 were you a member of the portfolio [95] committee? A. I think so, yes.

"Q. What were your duties in connection with being a member of that committee? A. Well, it is a very informal committee. The portfolio committee meets usually once a week, and sometimes acts on its own initiative, sometimes consults with the other individual members of the firm or the entire partnership and in general supervises the marketable security holdings of Lehman Brothers and buys or sells accordingly.

"Q. Is that portfolio committee in charge of purchasing securities for Lehman Brothers or directing the purchase of such securities? A. They purchase, they direct, and they advise. There is no cleavage. It depends upon individual cases.

*Deposition of William S. Glazier*

"Q. In 1954, are you aware that Lehman Brothers purchased 50,000 shares of the common stock of Tidewater Associated Oil Company? A. I am."

Mr. Levy: Question 3, page 5:

"Q. Did you have a discussion prior to your purchase of these securities? A. Oh, yes, that is right.

[96] "Q. And you discussed the matter with which of your partners? A. With Hammerslough and, I believe, with Herman Kahn, and there may or may not have been others; I wouldn't know.

"Q. Do you remember when for the first time you had such discussion? A. Well, I know that there was a discussion on the day the purchases began. Whether there were any discussions prior to that time, informal or not, and this is a very informal committee, I don't know. This was a matter that was known to us all, I mean in a general way."

Mr. Levy: Page 14, question 1:

"Q. Do you know the circumstances under which Mr. Thomas became a director of Tidewater? A. He was invited on the board.

"Q. What knowledge do you have concerning that? A. Nothing other than the fact that he was invited on the board and accepted.

"Q. Did he tell you about that? A. It was common knowledge around the office here. I don't know whether he told me specifically."

Mr. Levy: I have no further questions in [97]  
Mr. Glazier's deposition.

Mr. Vance: Your Honor, there are certain parts which I feel are necessary to be read to clarify what has already been read.

The Court: All right.

*Deposition of William S. Glazier*

Mr. Vance: Would you turn to the top of page 6, question 1:

"Q. Can you explain in what manner it was known to all of you? A. Well, prior to the initiation of the purchases there was a public statement, I believe in the Wall Street Journal some two or three weeks prior to that, that the directors of Tidewater Associated were considering an exchange of preferred stock for common stock, a voluntary exchange.

"Q. Was that the first time that you knew that Tidewater was considering an exchange of its common for preferred stock? A. That is correct, when the newspaper articles appeared. Whether there were more than one or not I don't know.

"Q. Who first brought it to your attention? A. I read the Wall Street Journal. I presume that I brought it to my own attention.

[98] "Q. On the day you read this article in the Wall Street Journal did you have a discussion with any of your partners or employees? A. I haven't the least idea."

Mr. Vance: Question 3 at the bottom of page 7:

"Q. Mr. Glazier, I assume that you read the Wall Street Journal every day. A. Yes.

"Q. Did you come across an article in the Wall Street Journal concerning these very facts written some time in September of 1954? A. Well, the date we are talking about of the initial purchases, as I recollect the record, was October 8th, and I said it was a couple or three weeks before that, so it must have been September. I don't remember the date.

"Q. Do you remember how many of these articles concerning these facts you read in the Wall Street Journal prior to Lehman Brothers commencing its purchases of Tidewater stock? A. No, I do not. I remember that there were at least two, the one which we have been talk-

*Deposition of William S. Glazier*

ing about here and a second one which I believe its appearance [99] was the same day as the initial purchase, which was to the effect that the Tidewater directors had approved the exchange of stock which would be submitted to the stockholders, I believe for stockholders' vote."

Mr. Vance: Turn to the bottom of page 11, question 2:

"Q. I show you, Mr. Glazier, Plaintiff's Exhibit 1 for identification and ask you whether you read this article in the Wall Street Journal. A. I believe so.

"Q. On the date it was published? A. I believe so.

"Q. And that date is September 17, 1954? A. September 17, 1954.

"Q. My question addressed to you, Mr. Glazier, is, after reading this article, Plaintiff's Exhibit 1, on September 17th did you have a discussion with any of your partners concerning these facts? A. I think I answered that, but I remember no specific discussion, but I wouldn't doubt at all that there had been some.

"Q. How long after reading this article was a direction given to purchase Tidewater stock for Lehman Brothers? [100] A. The direction to purchase Tidewater stock had nothing to do with this article. The direction to purchase Tidewater stock was after it was officially announced that the directors had approved making an exchange plan, putting an exchange plan up for a vote by stockholders.

"Q. Do you recall the date of that? A. Just by reference to this, which is October 8th.

"Q. I show you Plaintiff's Exhibit 2 for identification and ask you whether you read this article dated October 8, 1954. A. I believe so.

"Q. After reading this article did you have discussion with any of your partners? A. We did.

Q. With whom did you discuss the facts? A. With Hammerslough and Herman Kahn, and there may or may not have been others.

*Deposition of William S. Glazier*

"Q. How soon after reading this article was a direction given to purchase this stock, the Tidewater stock? A. The same day. I don't know what the time lapse was after reading the article and after the direction was given."

[101] Mr. Vance: Your Honor, the exhibits which were referred to in the testimony which we have just read as Plaintiff's Exhibits 1 and 2 for identification are those which have been marked Defendants' Exhibits A and B in evidence.

Would you now turn to page 20, question 2:

"Q. After Mr. Hertz resigned from the Tidewater board did you or any members of your firm in your presence or to your knowledge suggest to Mr. Thomas that he attempt to be elected as a director of Tidewater? A. No.

"Q. Was any discussion had concerning Mr. Thomas going on the Tidewater board? A. Not to my recollection.

"Q. Did you ever discuss the matter with Mr. Hertz? A. No."

Mr. Vance: Page 21, question 5:

"Q. Prior to the purchase of the Tidewater stock in 1954 did Mr. Thomas to your knowledge discuss the matter with any members of your Portfolio Committee or any other partners of your firm? A. No.

[102] "Q. Do I understand your answer 'No' to mean that you do not know? A. No, he did not discuss it to my knowledge with any members of the Portfolio Committee, certainly not with me."

Mr. Vance: That is all, your Honor.

The Court: We have about reached time for lunch, I guess, so we will stand adjourned until 2:15.

(A luncheon recess was taken until 2:15 P. M.)

*Colloquy*

[103] Afternoon session.

2:15 P. M.

The Court: I don't think we have to wait for Mr. Hays to come back from lunch. His interest in this litigation is somewhat academic, I should say, so if you want to you can proceed.

Mr. Levy: Very well.

If your Honor please, I would like to read into the record certain admissions made by the defendant, and I refer specifically to item No. 40 of plaintiff's notice to admit.

"That on December 8, 1954, the defendants Lehman Brothers converted 50,000 share of the common stock of Tidewater Associated Oil Company into 50,000 shares of its \$1.20 cumulative preferred stock."

This item has been admitted by the defendants. Item 41.

"That on December 8, 1954, the market range of the common stock of Tidewater Associated Oil Company was a low of \$25 and a quarter per share, and a high of \$25 and seven-eighths dollars per share."

The Court: Is the conversion of the stock [104] an important issue in this case?

Mr. Levy: Yes, sir.

The Court: Why?

Mr. Levy: We are claiming that the conversion into the preferred constituted a purchase of preferred stock under the statute, and that thereafter the defendants, within six months, sold the preferred stock realizing a profit from the preferred stock.



*Colloquy*

The Court: So you are basing this date from this December 8, 1954, date?

Mr. Levy: Yes.

The Court: What were those prices?

Mr. Levy: The common was selling at 25-1/4 low and at 25-7/8 high, and, of course, the reason, as you Honor well knows, why I am mentioning the common stock range is that under the cases the purchase price of the preferred is computed by what is given up for it, and in this case it is the common stock.

Mr. Vance: Your Honor, we object to this request on the ground that it is not relevant. It is our position that if there is any relevant period, it would be the period and the times and the purchase prices when the common stock was initially purchased and not [105] the date on which a conversion was made.

The Court: I understand. I will take the evidence anyway.

Mr. Levy: Item No. 42.

"That between December 9, 1954, and March 8, 1955, inclusive, the defendants Lehman Brothers sold 50,000 shares of its \$1.27 cumulative preferred stock of Tidewater Associated Oil Company realizing net proceeds therefrom in the sum of \$1,361,186.77."

That is admitted by the defendants.

Item No. 5 of the notice to admit.

"That for some time prior to, on or about December 6, 1954, the defendant John M. Hancock was a member of the board of directors of Jewel Tea Company."

That is admitted.

*Colloquy*

Mr. Vance: Objection, your Honor.

The Court: What relevancy does that have?

Mr. Levy: I am trying to show the plan or scheme showing that the defendant Lehman Brothers had a plan wherein they placed various of its directors upon the boards of various corporations—

The Court: That, I think, is completely [106] irrelevant. You are relying upon a statutory remedy here. You have elected to proceed on a statutory remedy.

Mr. Levy: May I, your Honor, read to you from the SEC position with respect to a partnership and with respect to the statute where the statute Section 16(b) of the statute says that "A director or an officer must account to his corporation for any short swing profits."

The Court: That is correct.

Mr. Levy: Now the word "director", your Honor, is defined in the statute under Section 3(a), subdivision 7, and it says "The term 'director' means any director of a corporation, or any person performing similar functions with respect to any organization whether incorporated or unincorporated."

The Court: I am well acquainted with that provision, but I don't see why we have to bring the Jewel Tea into something related to Tidewater Oil.

Mr. Levy: Well, it is our position, your Honor, that the close relationship between Joseph A. Thomas and his partners was such as to constitute them collectively, Lehman Brothers collectively, a person within the meaning of Section 3(a)(9) of the Securities [107] and Exchange Act of 1934, and, therefore, Lehman Brothers was

*Colloquy*

actually the director under the statute of Tidewater within the meaning of Section 16(b), and we are trying to show the general conduct of Lehman Brothers with respect to not only Tidewater but with respect to other corporations also.

The Court: Well, I am not going to take the fact that somebody who was a director of the Jewel Tea Company is any relevant proof in this case.

I will sustain the objection to that.

Mr. Levy: I have a whole line of admissions here similar in nature. I would like to read them into the record, and if your Honor sustains any objections there is nothing I can do about it.

The Court: You want to prove that partners of Lehman Brothers were directors of various corporations.

Mr. Levy: I want to prove that they were partners of various corporations and that as soon as one partner left as a director of a corporation Lehman Brothers had another partner go on the board of that same corporation. I want to prove a systematic course of conduct with respect to many corporations in which Lehman Brothers had its partners.

The Court: I am ready to assume that a number [108] of members of Lehman Brothers were directors of various corporations. I don't think you need to get any admissions of that. I think the Court can practically take judicial notice of that fact.

Anything other than that you will have to prove.

Mr. Levy: All right. That is what I am attempting to prove, your Honor. I am attempting to prove that with respect to certain corporations—

The Court: Go ahead and offer what your proof is, then.

*Colloquy*

Mr. Levy: "That for some time prior to on or about December 6, 1954, the defendant John M. Hancock was a member of the Board of Directors of Jewel Tea Company."

Mr. Vance: Objection.

The Court: Strike it out; completely irrelevant.

All right. Next question.

Mr. Levy: "That the defendant John M. Hancock resigned as a director of Jewel Tea Company, Inc. on or about December 6, 1954."

Mr. Vance: Objection.

The Court: Strike it out. It is irrelevant.

Mr. Levy: "That on or about December 6, 1954, [109] the defendant Harold J. Szold was elected as a member of the board of directors of Jewel Tea Company, Inc. and has been a director of said corporation to the present time."

Mr. Vance: Objection.

The Court: Strike it out; irrelevant.

Mr. Levy: "That in its proxy statement dated February 25, 1955, Jewel Tea Company, Inc. made the following statement: 'Mr. Szold was elected a director by the other members of the board to fill the unexpired term of John M. Hancock who resigned as of December 6, 1954, after 35 years of service on the board. Mr. Szold became associated with Lehman Brothers in 1924 and has been a partner of the firm since 1941.'"

Mr. Vance: Objection.

The Court: I will let that stand.

Mr. Vance: Then read the answer.

The Court: Is that the answer?

Mr. Carlson: That was not admitted.

Mr. Vance: That was not admitted in those words.

*Colloquy*

Mr. Levy: The defendants, with respect to plaintiff's item 8, "Admit that Jewel Tea Company, [110] Inc. issued a proxy statement dated February 25, 1955, but deny that the statement contained in item of said notice to admit constituted the entire proxy statement."

Mr. Vance: Your Honor, I make the further objection that what is stated in the proxy statement of the Jewel Tea Company is not binding on these defendants, besides being irrelevant.

The Court: It is not binding on the defendants; but, if Mr. Levy wants that particular part in, I will let it stay. I don't see that it has any relevancy whatsoever to the issues Mr. Levy has presented.

Mr. Levy: May I continue, your Honor?

The Court: Go ahead.

Mr. Levy: Item No. 9 in the plaintiff's notice to admit:

"During the periods in which the defendants John M. Hancock and Harold J. Szold, respectively, were directors of Jewel Tea Company the defendants Lehman Brothers have served said corporation in various financial capacities and have received payments for said services."

Mr. Vance: Objection.

[111] The Court: I will sustain any objection to an answer to that. It seems to me it is completely irrelevant.

Mr. Levy: The defendants—

Mr. Vance: It was sustained.

Mr. Levy: Item No. 10 in the plaintiff's notice to admit:

"That for some time prior to his death in the latter part of 1956 the defendant John M. Han-

*Colloquy*

cock was a member of the board of directors of the International Silver Company."

Mr. Vance: Objection.

The Court: I think that is completely irrelevant. I will sustain the objection.

Mr. Levy: Item No. 11:

"That on or about February 27, 1957, the defendant Frank J. Manheim was elected as a member of the board of directors of the International Silver Company and has been a director of said corporation to the present time."

Mr. Vance: Objection.

The Court: That is completely irrelevant. I will disregard that.

Mr. Levy: Item No. 12:

[112] "That in its proxy statement dated March 14, 1957, the International Silver Company made the following statement: 'The persons mentioned in the following table constitute the present board of directors elected by the stockholders last year except for Messrs. Frank J. Manheim and Ernest S. Wilson who were elected directors by the board in February, 1957, to fill the vacancies created by the deaths of Messrs. Everett C. Stevens and John M. Hancock. During the last five years Frank J. Manheim has been a partner in the firm of Lehman Brothers.'"

Mr. Vance: Objection.

The Court: I think that is irrelevant. They have to state what his connection is in a proxy statement.

Mr. Levy: Item No. 13:

"That during the periods in which the defendants John M. Hancock and Frank J. Manheim, respec-

*Colloquy*

tively, were directors of the International Silver Company the defendants Lehman Brothers have served said corporation in various financial capacities and have received payments for such services."

Mr. Vance: Objection.

The Court: I will sustain the objection. [113] It is irrelevant to the issues of this particular litigation. It might be relevant in another litigation, but not this.

Mr. Levy: Item No. 14:

"That for some time prior to on or about December 30, 1952, the defendant Robert Lehman was a member of the board of directors of General Cigar Company, Inc."

Mr. Vance: Objection.

The Court: I will sustain the objection.

Mr. Levy: Item No. 15:

"That the defendant Robert Lehman resigned as a director of General Cigar Company, Inc. on or about December 30, 1952."

The Court: I will sustain an objection.

Mr. Levy: Item No. 16:

"That on or about December 30, 1952, the defendant Harold J. Szold was elected as a member of the board of directors of General Cigar Company, Inc. and has been a director of said corporation to the present time."

The Court: Objection sustained.

Mr. Levy: Item No. 17:

"That in its proxy statement dated March 2, 1953, [114] General Cigar Company, Inc. made the following statement: 'H. J. Szold was elected a di-



*Colloquy*

rector of the third class of the company on December 30, 1952, to succeed Robert Lehman for the remainder of the term of directors of that class expiring in 1954. Mr. Lehman served as a director until the end of the year 1952. Both Mr. Lehman and Mr. Szold are partners of Lehman Brothers.' "

Mr. Vance: Objection.

The Court: I will let that stand.

Mr. Levy: Item No. 18—

Mr. Carlson: If your Honor please, we have not admitted that statement. These are requests for admission which are being read.

The Court: What is the answer to them?

Mr. Levy: With respect to item No. 17, the defendants stated as follows:

"Admit that General Cigar Company, Inc. issued a proxy statement dated March 2, 1953, but deny that the statement contained in item 17 of said notice to admit constitutes the entire proxy statement."

The Court: I think that is a ridiculous response to that. You neither admit nor deny, so [115] I will take the demand for admission in that particular item as admitted.

Mr. Levy: Item No. 18:

"That during the periods in which the defendants Robert Lehman and Harold J. Szold, respectively, were directors of General Cigar Company, Inc. the defendants Lehman Brothers have served said corporation in various financial capacities and have received payments for such services."

Mr. Vance: Objection.

The Court: Objection sustained.

*Colloquy*

Mr. Levy: Item No. 19:

"That during some part of 1950 and for some time prior thereto the defendant Paul M. Mazur"—

The Court: How many of these do we have to go through?

Mr. Levy: Just about ten more.

Mr. Vance: Through 39, your Honor. We are now at 19.

The Court: Why don't you make an offer of proof that the members of the board of directors of various corporations were partners in Lehman. I am perfectly willing to assume that that is so.

[116] Mr. Levy: My offer of proof, your Honor, would be that my notice to admit has requested the defendant Lehman Brothers to admit that with respect to at least ten corporations mentioned therein partners in Lehman Brothers were directors in that corporation, and that as soon as such partner resigned from the board of such corporation another member of Lehman Brothers became a director in said corporation, and that during the period during which the partners of Lehman Brothers were directors in these corporations Lehman Brothers served them in various financial ways and received commissions and other remuneration therefor.

I make such offer of proof in my notices to admit and the answers thereto.

Mr. Vance: The notices to admit and the answers thereto certainly do not establish what Mr. Levy says he would intend to prove.

The Court: Isn't it true, and can't we say, that it is agreed for the purpose of the record that Lehman Brothers have various partners who served on boards of directors of ten different cor-

## Colloquy

porations other than Tidewater Oil; that when one of those partners resigned in those ten cases that another partner of Lehman Brothers became a director of the particular [117] corporation?

Is that disputed?

Mr. Vance: Well, I don't know exactly how many cases there are, your Honor. But, if there is any suggestion that this is due to something on Lehman Brothers' part and not to a decision on the part of the directors of the company on whose board he went, then I would have objection to it.

The Court: Well, I realize that, but I don't think that that is comprehended in any of these questions. This is merely an historical statement of what actually happened. I think Mr. Levy would have to prove, if he wants to prove, that Lehman Brothers was responsible for this. He has not asserted that in any of these questions so far.

Mr. Levy: My offer of proof, your Honor, was to show a general course of conduct of Lehman Brothers with respect to these corporations and to show that such conduct carried over.

The Court: A course of conduct does not prove that Lehman Brothers was responsible for that situation.

Mr. Levy: No, but it is one way of showing that a certain thing was done, and we are trying to prove here that Lehman Brothers deputized and designated [118] Joseph Thomas to be on the board of Tidewater Oil Company.

The Court: So far none of your proof has established that, and I believe that merely the fact that they had certain directors on the boards does not prove that they were responsible for it.

You are falling into that logical fallacy of *post hoc, ergo propter hoc*: because something follows, therefore it is because of.

*Colloquy*

It isn't necessarily so. If you want to prove Lehman Brothers was responsible for these people being elected on the board, you have to prove that by evidence. I am perfectly willing to assume, on the basis of your offer of proof, from what I have heard already that certain partners of Lehman Brothers were directors of various corporations; when certain of those directors resigned other directors were elected who were partners of Lehman Brothers.

Mr. Levy: My further offer of proof, your Honor, is to show that Lehman Brothers served the corporations upon whose boards their members were directors in various financial capacities and earned fees and other remunerations.

The Court: That I am perfectly willing to [119] say I will accept as being established, but I think it is completely irrelevant, and therefore I strike it out of consideration in this case.

It might be relevant in another type of case. There may be a conflict of fiduciary duty there, but I am not dealing with that because that is not the complaint which is made in this case.

I don't see any necessity of going through 29 or 39 more demands for admission and the answers to them to establish something concerning which there can be no substantial dispute. The conclusion, however, I think is disputed by Mr. Vance.

Mr. Levy: Well, I assume, then, your Honor, that I need not proceed any further with respect to these items.

The Court: No, I think not.

Mr. Levy: And that I have made my offer of proof thereof.

May I offer pursuant to the suggestion of Lehman Brothers' counsel, the plaintiff's notice to admit dated—

*Colloquy*

The Court: How do you want to offer it, as an exhibit?

Mr. Levy: Yes.

[120] The Court: No. That is a pleading. It is part of the court record.

Mr. Levy: In view of the fact that there has been a stipulation entered into which preserves the right of the defendants to object to any of the items, can it be construed a pleading?

The Court: Well, the demand to admit is nothing other than a form of pleading. You read the demand. You read the admission or the denial of it. It isn't a piece of evidence in and of itself any more than a complaint or an answer is.

Mr. Levy: Well, I understand from the defendants' counsel that he is willing to have these items put in as exhibits.

Mr. Vance: No, I didn't say that.

The Court: They are part of the court record. They will be taken like the pleadings as part of the court record, of course.

Mr. Vance: My objection, your Honor—I hope that my objection is registered to each and every one of these which he is now offering to prove.

The Court: On the ground that they are irrelevant?

Mr. Vance: On the ground that they are [121] irrelevant, yes, your Honor.

Mr. Levy: Your Honor, that winds up the plaintiff's case with the exception of proving the percentage of interest which Mr. Thomas had in the Lehman Brothers partnership during the period December 8, 1954, through March, 1955, and I now request counsel for the defendants to state on the record what such interest was at that time.

*Colloquy*

Mr. Vance: If your Honor please, I will describe it to the best of my ability as I understand it.

Mr. Thomas was entitled to share in 4 per cent of the first 47.05 per cent of any profits which were realized. He was then entitled to share, on the basis of 1.85 per cent, in the remaining profit realized by the firm.

The Court: What was that first number? 4 per cent of what?

Mr. Vance: 4 per cent of 47.05.

And then in 1.85 per cent of 53.95, if my arithmetic is correct.

Mr. Levy: You mean the balance, the remaining balance of 53.—

Mr. Vance: Excuse me for a minute.

[122] Mr. Levy: 52.95.

Mr. Vance: I am 1 per cent over. He shares on the basis of 1.85 per cent of the balance.

The Court: Which is 52.95.

How does he share in the losses?

Mr. Vance: On the same basis.

The Court: Does he have any other interest in the partnership?

Mr. Vance: That is all, your Honor.

The Court: All right. Now, have you anything else, Mr. Levy? You haven't proved what the profits were that were attributable to Mr. Thomas.

Mr. Levy: Your Honor, I believe that from the admissions we have the following facts emerging which are indisputable, and that is that between December 8, 1954, and March, 1955, Lehman Brothers purchased and sold 50,000 shares of Tidewater preferred stock.

Now, on the date on which they converted their common into preferred, which we maintain is a

*Colloquy*

purchase under the cases, the common stock was selling for 25-1/4 to 25-7/8 dollars per share.

Now, in view of the fact that the purchase price of the preferred would be measured by the value [123] of the common given up, and in view of the further fact that Section 16(b) of the Securities and Exchange Act attempts to squeeze all profits out of stock transactions, it is submitted that we take the lower market figure of the common stock, or 25-1/4 dollars per share for the purchase price of the preferred stock, so that each share of the preferred stock at 25-1/4 dollars would add up to \$1,262,500 for the purchase of 50,000 shares of Tidewater preferred.

Now, it has been stipulated that the defendants received the net sum of \$1,361,186.77 from the sale of the preferred stock, leaving a profit realized in the sum of \$98,686.77, for which the plaintiff, your Honor, seeks judgment with interest from March 8, 1955.

The Court: Is there any dispute about those figures, Mr. Vance?

Mr. Vance: Your Honor, as I previously indicated, it is our position that there was no purchase on December 8th, such as Mr. Levy asserts.

Secondly, your Honor, there has been no proof that Mr. Thomas realized any profits.

The Court: Let us break it down. In the first place, have you got any authority on the question [124] as to whether a conversion of stock may be regarded as a purchase?

Mr. Vance: Yes, sir, and I put them in my pre-trial memorandum.

The Court: Now, is there any dispute that if you take the date of December 8th as the date of purchase, that the Lehman Brothers made a profit of \$98,686.77?



*Colloquy*

Mr. Vance: Your Honor, I have not done the mathematics on that. If you will give me just a second I will do that very thing.

(A pause)

Mr. Vance: Subject to computation, your Honor, I don't want to hold you up, I will assume for the time being that his mathematics is correct.

The Court: All right. Now, where is the proof as to how much Mr. Thomas made, Mr. Levy?

Mr. Levy: If your Honor please, it has just been stipulated that Mr. Thomas owned a 4 per cent interest in the first 47.05 per cent of the profit of Lehman Brothers.

Now we are proceeding on the fact that not only is Mr. Thomas' direct interest in Lehman Brothers recoverable, but that the entire profit realized [125] by Lehman Brothers is recoverable under the statute, and if your Honor will bear with me for just a moment, I would like to read to your Honor and quote from an SEC position with respect to partnership short swing profit. And I am quoting:

"It is not disputed that Section 16(b) reaches transactions by a partnership, a partner of which is a director (or other insider) of the issuer of any equity security registered on a national securities exchange. 'For the purpose of preventing the unfair use of information which may have been obtained by such . . . director,' Section 16(b) provides that 'any profit realized by him' from short swing trading 'shall ensure to . . . to the issuer.' The dispute is whether the language 'any profit realized by him' covers only the director's beneficial interest in any partnership profits, or the entire profit realized by the firm in which he had an undivided interest."

*Colloquy*

The Court: What did they decide on that?

Mr. Levy: Well, they decided that it should reach the entire interest of the partnership, but in view of the fact that they had a certain rule requiring the disclosure of a partnership's interest at that time, [126] they went along with the court in that only the proportionate share of the partner's interest should be recoverable in that case, but now—

The Court: Are you establishing what that is in this case? Are you seeking a judgment against Mr. Thomas?

Mr. Levy: I am seeking a judgment against both Mr. Thomas jointly and severally.

The Court: Suppose there is no judgment against Lehman Brothers, do you drop your request for a judgment against Mr. Thomas?

Mr. Levy: No, sir. I say to your Honor that in view of the fact that he owned a 4 per cent interest in Lehman Brothers' profits he was a general partner, the minimum, even under the defendants' view, must be 4 per cent of the profits realized by him.

The Court: Not necessarily. I mean, here is a firm where he has a 4 per cent interest in the first 47.05 per cent profit. Now, is this part of the first 47.05 per cent of profit? Is it part of the 52.95 per cent of the profit?

Mr. Levy: That, your Honor, I would not know.

The Court: Well, it is your case, not mine.

[127] Mr. Levy: But in view of the court's statement in *Gratz v. Claughton*, 187 F. 2d 46 (C. A. 2, 1951) where certiorari was denied, it is well established that a trustee's firm may not benefit from transactions with the trust. A defendant's misdeeds puts the transactions in such a confused state that we must take the maximum amount that can be recovered.

*Colloquy*

The Court: There is nothing confused about this. You said had, I suppose, two years, probably, to get this information.

Mr. Levy: Well, I have requested, your Honor, the defendant upon his examination, to state his interest in the partnership, and he has refused to so state, and it is only upon this trial for the first time that I have been apprised as to what his interest was.

The Court: You could easily have come to court at any time and gotten that information. The Court would have directed it from the very beginning.

Now, they also would have made it possible for you to find out how much his interest was in these profits. I am not going to surmise as to what it was. The books of the partnership must show what it was.

[128] Mr. Levy: All you have to prove, your Honor, I believe, is that that partnership realized the profit.

Now, it is up to the defendant's director to show that the amount of profit with respect to him must be less. I don't believe, your Honor, that it is up to me prove what his proportionate interest in the partnership was.

The Court: Then it may be that we cannot enter any judgment against him individually if we cannot enter it against the firm.

Mr. Levy: Of course, I press my—

The Court: Due to the fact that you have not got the necessary information in preparation for the trial.

Mr. Levy: Of course, your Honor, I press the fact that we request judgment here against the Lehman Brothers partnership for the full amount

*Colloquy*

of the profit on the ground that the Lehman Brothers partnership as an entity was a director within the meaning of the—

The Court: You don't mean the Lehman Brothers was a director, do you?

Mr. Levy: Was an entity and as an entity was [129] a director, that's right, within the meaning of the statute, your Honor.

The Court: Did Lehman Brothers file the reports of purchases and sales like directors have to do on listed securities?

Mr. Levy: The directors file the purchases and sales indicating how many purchases and sales were effected by Lehman Brothers during the periods in question.

The Court: As an affiliate of the person, I suppose.

Mr. Levy: That is correct.

May I read just a couple of pages of—

The Court: Is it in your brief?

Mr. Levy: No. I would like to have that on the record, and perhaps your Honor would be helped by it with respect to the SEC's thinking in this matter.

The Court: I would be very glad to have it in written form.

Mr. Levy: Well, it is very short.

The Court: An SEC release, is it?

Mr. Levy: No. It is an SEC statement released in the case of *Ratner v. Lehman Brothers* [130] in 1951.

The Court: That is not necessarily a view of the SEC, if it is a brief written by some lawyer employed by the SEC in a particular case.

I am perfectly willing to look at an SEC order, or things like that, but I am not ready to take all the effusions of their counsel.

*Colloquy*

Mr. Levy: May I, your Honor, make a statement, then, adopting for myself what the SEC said in its brief, just a short statement, and perhaps then I can put this in a different light?

The Court: Why not put it in your brief so that I will have it when I can examine your case?

Mr. Levy: If your Honor would like me to do that, I will. I thought perhaps by reading it—

The Court: All right, go ahead and read it.

Mr. Levy: The SEC said as follows:

“Section 16(b) declares the provision for the surrender of profit to be ‘for the purpose of preventing the unfair use of information which *may* have been obtained’ through an inside relationship to the issuer (emphasis supplied). It was intended to operate irrespective of actual proof of abuse of inside information. Congress, [131] recognizing that the specified relationships commonly carry with them access to inside information but that proof of abuse in the particular case would be very difficult, thought that elimination of the profit motive would have the effect of ‘preventing’ insiders ‘from speculating in the stock on the basis of information not available to others’ and that the provision would ‘render difficult or impossible the kind’ of transactions which were frequently described to the committee, where directors and large stockholders participated in pools trading in the stock of their own companies, with the benefit of advance information \* \* \*

“To construe Section 16(b) as not reaching, under any circumstances, more than the partner’s proportionate interest in a firm transaction is to both to adopt an unrealistic conception of the nature of a partner’s interest in profit realized by

*Colloquy*

the firm, where the partner may have been instrumental in enabling the firm to profit, and to strip most of the force from a statutory sanction which was intended to completely eliminate the profit motive for such transactions. Where [132] the partnership does obtain inside information from the director-partner which might otherwise tempt it to engage in a short-swing trade, the possibility of being required to surrender a portion of the profit, measured by the individual interest of the director-partner, would neither operate as an effective deterrent to the firm, nor deter the director-partner from passing on inside information to his firm.

"We believe that the individual partner has an undivided interest in the entire firm profit. This is traditional partnership law. It also makes practical sense in the context of Section 16(b). Thus, even though the partner surrenders to the issuer a sum measured by his proportional interest in the firm profit, there can remain many ways in which he would benefit from the profit which the firm would retain. A crude illustration would involve a practice of mutual sharing of inside information by members of a partnership with representation upon a number of boards of directors. The firm could thereby speculate extensively upon the basis of information derived in various situations where members of the firm might be represented on the boards [133] of the issuing companies, surrendering merely a fractional interest in the profit corresponding to that of the interests in the firm held by the particular partner involved. Quite apart from such an exclusive arrangement for sharing the prerequisites of inside information, it may be generally assumed

*Colloquy*

that partnership participations are adjusted from time to time to reflect what each partner contributes to the firm, taking into account services, connections and other intangibles as well as concrete investment.

"Moreover, it seems clear that Congress, in enacting Section 16(b), did not intend to impose lower fiduciary standards than would apply in its absence. See *Gratz v. Claughton*, 187 F. 2d 46 (C. A. 2, 1951) certiorari denied by the United States Supreme Court. It is well established that a trustee's firm may not benefit from transactions with the trust. Similar considerations should be here applicable."

The Court: I take it, however, that that brief was submitted to the Court of Appeals, was it not?

Mr. Levy: Yes, sir.

The Court: What happened?

[134] Mr. Levy: It was submitted as *amicus curiae* by the SEC.

The Court: The Court of Appeals did not accept that argument?

Mr. Levy: No. The Court of Appeals decided it on a different basis, your Honor.

The Court: They did not accept the argument that the profits of the firm could be recovered in this type of action, did they?

Mr. Levy: As your Honor knows, the Court of Appeals stated that no proof had been offered by the plaintiff that any of the partners had actually given any information or received any information from the partner directors.

In this case we have attempted, and I think that we have proven that information has been



*Colloquy*

passed on by Mr. Thomas to various members of the partnership, and that they purchased the common stock which they thereafter converted into preferred stock on the basis of such information.

The Court: I don't understand that you have established that at all.

The facts as shown here would indicate that they purchased it because of articles appearing in the [135] Wall Street Journal, but, as I understand it, the Court of Appeals in the *Ratner* case simply held that the profits of the firm did not have to be accounted for, that despite anything that the SEC may have said.

Judge Learned Hand, in his concurring opinion, said that the only question in the case is whether partners are liable for whatever profit the firm may make whenever one of their members is a director only because he is a director. He says that he agrees that 16(b) does not go so far.

Mr. Levy: If your Honor will read the majority opinion by Judge Swan I think he has something to say with respect to partnership too.

He says, I believe, that in certain instances partnerships may be held.

Mr. Vance: Mr. Levy, I don't believe that is what the opinion says.

Mr. Levy: Well, I think the Judge can well decide what it says.

Mr. Vance: He certainly can.

The Court: The majority opinion says that Section 16(b) contains no provision requiring the partners or the directors to account for the profits [136] realized by them. It says, the appellant argues that to construe the section so literally as to exclude them leaves a dangerous loophole in the statute, but the legislative history indicates

*Colloquy*

that the admission of any provision for such liability was intentional.

It seems to me that despite whatever the SEC may have said in an abortive brief it may have filed with the Court of Appeals, this court is bound by what the Court of Appeals said.

In the *Ratner* case the Court of Appeals, with your brief and the SEC brief before it, concided that Section 16(b) does not mean that partners of a director are liable for profits made by them. Maybe Congress left a loophole in the statute, but it is not the power of this court to enact legislation to correct loopholes. And as far as I can see, you have established no proof as to what the profit of Mr. Thomas was in this particular transaction.

Mr. Vance: Have you completed your case, Mr. Levy?

Mr. Levy: Yes, I think I have finished my case.

Mr. Vance: Your Honor, I move to dismiss under Rule 41(b) first as to defendant Lehman Brothers [137] and all of the partners other than Mr. Thomas on the ground that as a matter of fact and law there is no liability with respect to Lehman Brothers or any of the partners other than Mr. Thomas out of any profit which may have arisen out of the transaction in connection with the Tidewater stock, and I specifically rely on the decision of the Court of Appeals in the case of *Ratner v. Lehman*.

I also move to dismiss as against defendant Thomas on the ground that Mr. Thomas would only be liable if it had been shown that he realized a profit. That is the specific wording of Section 16(b).

*Colloquy*

I submit, your Honor, that there has been absolutely no proof that Mr. Thomas realized any profit, and that therefore the action must be dismissed as to him.

And finally, your Honor, Mr. Thomas could have no liability in so far as any profits which the partnership might have realized under the doctrine set forth in the opinion in *Ratner v. Lehman*.

I therefore move to dismiss both on behalf of Lehman Brothers and all of the partners who are named as defendants in the action.

The Court: You don't think that Mr. Thomas [138] made any profit on this transaction at all?

Mr. Vance: No, sir.

The Court: Well, if it were stipulated that Lehman Brothers made \$98,686 profit, then Mr. Thomas, I suppose, made some profit.

Mr. Vance: No, sir, he made no profit.

The Court: I will grant your motion in so far as it dismisses the action against Lehman Brothers other than Mr. Thomas.

As to Mr. Thomas, I am still somewhat puzzled on the facts as to whether he has or has not made a profit as to which he must account.

Mr. Vance: Are you reserving decision on that, your Honor?

The Court: I will reserve decision and let you put in any proof you wish.

Mr. Vance: Your Honor, I would like to call Mr. Isidore Monblatt to the stand.

*Isidore Monblatt, for Defendants, Direct*

ISIDORE MONBLATT, called as a witness, having been first duly sworn, testified as follows:

*Direct Examination by Mr. Vance:*

Q. Mr. Monblatt, where do you live? A. 1562 East 4th Street, Brooklyn, New York.

[139] By whom are you employed? A. Lehman Brothers.

Q. In what capacity are you employed by Lehman Brothers? A. I am assistant to the comptroller.

Q. How long have you held that position? A. Since 1952.

Q. What are your duties as assistant to the comptroller? A. My regular duties are to prepare the Federal partnership tax returns, the State partnership tax returns, the Unincorporated Business tax report, gross receipts tax, and to distribute the profits to the partners.

Q. What do you mean by "to distribute the profit to the partners"? A. At the year end I prepare the computations to distribute the firm's profit to the partners.

Q. Were your duties the same in 1954 and 1955 as you have just described? A. Yes.

Q. Mr. Monblatt, I show you a document and ask you whether you recognize it? A. Yes, I do.

[140] Q. Would you tell me what it is? A. This shows the distribution on the sale of 1,400 shares of Tidewater Associated preferred in 1954.

Q. Who prepared that document? A. I did.

Q. Did you prepare it yourself or did you have someone else prepare it for you? A. No, I prepared it myself.

Mr. Vance: Your Honor, I would like to offer this in evidence as Defendants' Exhibit C.

The Court: Show it to Mr. Levy.

*Isidore Monblatt, for Defendants, Direct*

Mr. Vance: Yes, I have got a copy here for both the Court and for Mr. Levy (handing).

Mr. Levy: If your Honor please, I object to this document being offered in evidence on the ground that there is no proof here that the shares involved in the present lawsuit are part and parcel of this document.

The Court: Are these the shares that Mr. Levy has been talking about, Mr. Vance?

Mr. Vance: They are. Let me ask a question of Mr. Monblatt.

Q. Mr. Monblatt, does this document reflect the [141] sales of all shares of Tidewater stock by Lehman Brothers during the year 1954? A. Yes, sir.

Mr. Vance: Your Honor, there will be another schedule for 1955, if that is what is puzzling you.

The Court: They sold them in '55, I suppose.

Mr. Vance: They sold some in '54, your Honor, and some in '55.

The Court: Did the profits add up anywhere near the sum that Mr. Levy talked about of some \$98,000?

Mr. Vance: No, sir, they did not. And the reason that they did not is that the purchase price is the amount that was actually paid for the shares, your Honor.

The Court: Not the value at the time of the conversion?

Mr. Vance: That is correct, your Honor. The figure that Mr. Levy talks about is a purely theoretical figure which never existed.

Mr. Levy: It is this supposed theoretical figure, your Honor, which was actually taken to compute the purchase price. It is what they gave up, the [142] common stock value that they gave up, that

*Isidore Monblatt, for Defendants, Direct*

determines what the price was, what they paid for the preferred stock received, and, therefore, if any other computation is made in this document being presently offered, it is not the proper computation, and I object to it as being offered in evidence.

Mr. Vance: That is a conclusion which you are drawing, Mr. Levy.

The Court: What exactly is this profit of Mr. Thomas here anyway?

Mr. Vance: I will show your Honor through Mr. Monblatt that it is nothing.

The Court: Well, I will reserve decision on the objection first. You better establish what this does show. It is all Greek to me.

Mr. Vance: All right, your Honor.

Q. Now, Mr. Monblatt, will you describe to us what this document is and how you drew it up, and what it shows, starting with the first column. A. First there are the profits that are distributed on two bases, the non-capital basis and the capital basis. On the non-capital basis that is 47.05 per cent. They got the top distribution of the profits. The first distribution made was as to that 47.05. The balance [143] was then distributed on the capital basis.

Intead of distributing on 47.05 I deducted Joe Thomas' percentage, that 4 per cent, and distributed only 43.05 on the first basis. The balance then—

Q. Are you referring to the column headed "Non-capital" in the testimony which you have just given? A. That's right.

Q. Please go ahead.

The Court: What was the profit you were starting with?

The Witness: I started with a book profit of \$1,068.73.

*Isidore Monblatt, for Defendants, Direct*

The Court: So that is all we are talking about on this then?

The Witness: That's right.

Q. How did you arrive at the book profit which is shown as \$1,068.73? A. The cost of the securities—the proceeds, rather, less the cost of the securities, and that left \$1,068.73.

Mr. Levy: If your Honor please, I again reiterate my objection. The cost of the securities, by that I assume the witness means the cost of the common [144] securities, the common shares, and that is not the proper basis of computing profits under the case of *Park & Tilford v. Schulte*, and other cases, your Honor.

The Court: You may be right, but let us go ahead with this and see if we can find out what he is talking about.

Q. Go ahead, please. A. The book of \$1,068.73—I deducted from that the expenses of 10.30 per cent, which left me a profit figure—

The Court: Where did you get 10.30?

The Witness: 10.30 consists of the state unincorporated Business tax, the city gross receipts tax, the employee's profit sharing plan—that is 5 per cent— and there are several employees that share in the profits. The total is 10.30 per cent.

Mr. Levy: If your Honor please, may I say—again, I am sorry to interrupt—that the gross receipts tax and any other tax of whatever nature is not deductible from profit in a Section 16(b) action.

Mr. Vance: We make no contention that it is.



*Isidore Monblatt, for Defendants, Direct*

Q. Would you go ahead, Mr. Monblatt. A. That left me a balance to distribute of \$958.65 [144-A] from which I distributed 43.05 per cent to the non-capital partners. That left me a balance of \$545.93, which I distributed to the capital partners less Joseph Thomas.

[145] Q. Was any part of the \$1,068.73 distributed to Mr. Joseph Thomas? A. No.

The Court: Why not? I still don't understand why not. Why wasn't it?

Q. Can you answer that question?

The Court: He had a 4 per cent interest. Why didn't he get 4 per cent of that amount?

A. Well, when I was—

Q. Did you receive any instructions from Mr. Gardner, who was the controller, with respect to what you should do? A. In preparing the SEC form 4 there was a waiver on it, on which Joseph Thomas waives his interest in the purchase of these securities. I make my note from that and when I have any profits to distribute on the sale of those securities I automatically take them out.

The Court: Who gets the profits, the other partners, then?

The Witness: The other partners share a hundred per cent in that profit.

Mr. Levy: If your Honor please, will you tell the witness to speak up, please? I can't hear him.

[146] The Witness: I am sorry.

The Court: What is this waiver you are talking about? This isn't on this document, not on your computation, so you were basing your computation on a waiver which is another document?

*Isidore Monblatt, for Defendants, Direct*

The Witness: That's right.

By Mr. Vance:

Q. Mr. Monblatt, I show you several documents which purport to be form 4s filed by or on behalf of Mr. Joseph A. Thomas, and I ask you whether any of those is the document on which you saw the waiver which you have testified about. A. That's right. This is the waiver in which I made my note for the distribution of the profits (indicating).

Q. What document are you referring to? A. The waiver is on—

Mr. Levy: If your Honor please, I object to this evidence on the ground that it hasn't been established that the defendant Thomas waived anything except from what this witness says.

The Court: That is what they are about to try to prove, I gather.

What is this waiver?

[147] The Witness: The waiver is on the form 4 to the SEC.

The Court: Is it signed by Mr. Thomas?

The Witness: It is signed by Mr. Gardner, agent in fact for Mr. Joseph A. Thomas.

Mr. Vance: Your Honor, I will establish through Mr. Thomas, who is now in the court room, what happened with respect to these form 4s. However, Mr. Monblatt was here, and I wanted to get him off the stand and therefore we proceeded with him before Mr. Thomas.

The Court: All right. So in effect all of this computation of the profit on Tidewater means nothing because you say Mr. Thomas did not share in it in any way.

The Witness: That's right. He got no part of it.

*Isidore Monblatt, for Defendants, Direct*

The Court: I will sustain the objection at this time.

Mr. Vance: You sustain the objection to the document?

The Court: Yes. It doesn't mean anything as far as Mr. Thomas is concerned.

Mr. Vance: It establishes that he received [148] no part of the profit.

The Court: Not this doesn't; maybe some other document does.

Mr. Vance: Your Honor—

The Court: He himself can testify as to whether he received it. But this document doesn't establish it.

Mr. Vance: Your Honor, this is the man who makes the computations at the end of the year on all of the transactions and credits or does not credit to the various partners' accounts the profits which are earned by the firm. He is testifying that these are the computations which he made and that as a result of the computations which he made in the Tidewater transaction no profit which was realized to Lehman Brothers was credited to the account of Mr. Thomas.

The Court: I understand that. Why do I need all these figures?

Mr. Vance: These are to substantiate that fact, your Honor.

The Court: He says he didn't credit anything to Mr. Thomas. When you get down to it, it isn't because of these figures; it is because of a separate waiver that somebody signed.

[149] Mr. Vance: This will establish the fact, your Honor, that as a matter of bookkeeping within the office of Lehman Brothers the waiver was carried out and that in fact—no money.

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*Isidore Monblatt, for Defendants, Direct*

The Court: He can so state, but I don't need all those figures about these other partners and all that to establish that fact.

Mr. Vance: Your Honor, I would like to make an offer of proof on that because I believe it may be necessary to do that.

The Court: I am not going to take this miscellaneous lot of figures which can't be explained to my satisfaction.

Mr. Vance: Will your Honor, let me try once again, if I may, to explain this to your satisfaction.

By Mr. Vance:

Q. Mr. Monblatt, what does the figure \$1,068.73 show?

A. That is the book profit on the sale of 1400 shares of Tidewater preferred.

Q. Is that all of the shares of Tidewater preferred which Lehman Brothers sold during the year 1954? [150]

A. Yes.

Q. Was any portion of that profit credited to the account of Mr. Joseph A. Thomas at the end of the year 1954 or at any other time? A. No.

Mr. Vance: Your Honor, I submit this schedule reflects that fact.

The Court: Why not?

The Witness: Well, I base my calculations on—first of all, I saw the waiver that Joseph Thomas—

The Court: Mr. Thomas waived any interest in the profits.

The Witness: —waived any interest in that.

The Court: If he had not waived, he would have received a certain amount of profits, wouldn't he?

The Witness: That's right.

The Court: How much would he have received?

*Isidore Monblatt, for Defendants, Direct*

The Witness: Well, he would have received—I can give you a rough calculation of this; I would say about sixty or seventy dollars on the 1400 shares.

The Court: So he waived that.

The Witness: That's right.

The Court: All right. You have your proof.

[151] Mr. Vance: I renew my offer of this document in evidence, your Honor.

The Court: I don't think the document proves anything by itself. I think this witness's testimony proves what you want, not the document.

Mr. Vance: I think it does, too, but I think that the document is important also, your Honor.

The Court: I will sustain the objection.

By Mr. Vance:

Q. Mr. Monblatt, I show you another document and ask you what that is. A. That is the distribution of the book profit of the Tidewater preferred for the year 1955.

Q. Who prepared that document? A. I did.

Q. Did anyone assist you in its preparation, or are those your actual figures on the paper? A. Those are my figures.

Q. Mr. Monblatt, will you tell us how you prepared that document and describe the manner in which the distributions reflected on that sheet were made? A. I took the book profit on the sale of the Tidewater preferred in 1955. I distributed them according to the partnership agreement, omitting Mr. [152] Thomas from my calculations. I distributed the entire profit to all the other partners.

Q. What was the total profit which was being distributed as reflected on that sheet? A. The book profit was \$29,318.04.

Q. Was any portion of that profit distributed to Mr. Joseph A. Thomas' account? A. No.

*Isidore Monblatt, for Defendants, Cross*

Q. Mr. Monblatt, do the computations on that sheet reflect all of the sales of Tidewater preferred stock made in 1955 by Lehman Brothers? A. Yes.

Mr. Vance: Your Honor, I offer this document in evidence.

Mr. Levy: Which document are you offering?

Mr. Vance: The same one. You have it right there.

Mr. Levy: Where is the original?

Mr. Vance: He has it right there.

Mr. Levy: If your Honor please, I object on the same ground as my previous objection.

The Court: Objection sustained. The document means nothing. Mark this as D for identification.

(Marked Defendants' Exhibit D for [153] identification.)

Mr. Vance: Thank you, Mr. Monblatt.

The Court: Any cross-examination?

Mr. Levy: May I reserve my cross-examination?

The Court: If you want a five-minute recess, you can take that, if you want to organize your cross examination.

Mr. Levy: No, I think I can go along with it now.

*Cross Examination by Mr. Levy:*

Q. Where did you get all these figures from which you read to this Court? A. I took them off the firm's books.

Q. And who put them on the firm's books? A. The accountant in charge—who takes them off the daily blotters.

Q. And do you know how the profits were computed with respect to the Tidewater preferred stock? Are you personally familiar with how it was done? A. Yes.



*Joseph A. Thomas, for Defendants, Direct*

Q. Can you explain to us how it was done? A. Well, the proceeds less the cost on the books are the profit we distribute.

Q. The cost of what? [154] A. The cost of the—we originally started with the common, converted it into preferred, and transferred our costs to the preferred.

Q. In other words, you used the common stock purchase price as your basis for the cost of the preferred. A. That's right.

Q. You did not use the common stock market range on the date the common was converted as the basis for the preferred stock cost, did you? A. No.

Mr. Levy: That is all.

Mr. Vance: No questions, your Honor.

The Court: You are excused.

(Witness excused)

Mr. Vance: I would like to call Mr. Joseph A. Thomas to the stand.

The Court: We will take a three-minute recess.

(Short recess)

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JOSEPH A. THOMAS, having been first duly sworn, testified as follows:

*Direct Examination by Mr. Vance:*

Q. Mr. Thomas, are you the Joseph A. Thomas who is a defendant in this action? [155] A. I am.

Q. What is your occupation, Mr. Thomas? A. General partner of Lehman Brothers.

Q. How long have you been a general partner of Lehman Brothers? A. Since January 1, 1937.

Q. Mr. Thomas, when was the first time in 1954 that you learned that Lehman Brothers had purchased any se-



*Joseph A. Thomas, for Defendants, Direct*

curities or was to purchase any securities of Tidewater Oil Company? A. Every day I get across my desk the purchases and sales executed by my firm for itself or customers in the form of purchase and sales sheets. They usually come around, except for week ends, of course, on the following day. I saw this purchase of Tidewater on the sales sheets.

Q. Can you tell us approximately when that was?

Mr. Levy: If your Honor please, these questions have already been asked and answered in the questions and answers read from Mr. Thomas' deposition.

The Court: If he wants to repeat them, that is all right.

By Mr. Vance:

Q. Can you tell us approximately when that was? [156]

A. I believe it was around the first part of October. I can't be certain as to the exact date.

Q. What did you do, if anything, after you saw this purchase slip come across your desk? A. Well, I went in to see my senior partner, Mr. Robert Lehman, and asked what was the purpose of the purchase. He told me in support of an Arbitrage transaction. We have a regular Arbitrage Department in our firm.

Q. What did you say? A. I said I was a director of Tidewater and it could be embarrassing to me, if it was an Arbitrage transaction, because I would presume the sale of these securities in a short time, and I did not want any part of the transaction to reflect on me. So he said, "Well, you had better do something about it."

So I called Morris Gardner, our controller; I gave him instructions to exclude me from any risk of the purchase or any profit or loss from the subsequent sale and to take the necessary steps to carry out my instructions.

*Joseph A. Thomas, for Defendants, Cross*

Q. Did you have any discussions with your partners generally about this? A. I had no discussions. We have a partners [157] meeting every Monday at lunch, and to the best of my memory the following Monday I said, "I want you all to know that I am not a part of this Tidewater transaction at all. I am a director of the company and I have excluded myself from any profits or losses there."

The Court: Did they agree?

The Witness: Yes, sir.

Q. Did you receive any profit from this transaction?  
A. No, sir.

Mr. Vance: That is all, your Honor.

*Cross Examination by Mr. Levy:*

Q. Do you know how much profit was earned by Lehman Brothers from the purchase and sale of the 50,000 shares of Tidewater preferred stock? A. I did not know until Mr. Blau brought his action. I wasn't a part of it and I didn't have any idea.

Q. Do you know at the present time?

Mr. Vance: I can't see what relevance this has.

The Witness: I don't mind answering the question.

The Court: Let him answer the question.

[158] A. At the time of the deposition it was alleged in the neighborhood of \$100,000.

Q. And how much of that profit did you supposedly waive? A. Well, at that time I believe my interest was about 4 per cent. I guess it would have been about \$4,000. That is before taxes.

Q. Were you in this court room when Mr. Monblatt was testifying? A. I heard his four last answers, yes.

*Joseph A. Thomas, for Defendants, Cross*

Q. And he testified, I believe, if I am correct, that Lehman Brothers realized a profit from the purchase and sale of preferred stock in the neighborhood of approximately \$29,000. A. I thought he said 109. I couldn't hear him back there very well. I really did—I never examined the books on the transaction because I had no interest in them.

Q. Is there a separate page kept for every partner who is a director in a corporation. A. I am not aware of the mechanics of the bookkeeping. There are a set of partners' books that cover his individual securities accounts and records which, of course, would be maintained for tax purposes [159] anyway.

Q. Is it customary for a partner who is a director in a corporation to waive his interest in the short swing profits realized by a corporation?

Mr. Vance: It doesn't make any difference if it is customary.

The Court: You mean in Lehman Brothers, if it is customary?

Mr. Levy: Yes, sir.

A. I think customary is a pretty strong word. But all of us are aware of the existence of 16(b) and you certainly wouldn't want to find yourself in that predicament.

Q. Do you know of any other case where the profits were supposedly waived from such similar transaction by a member of Lehman Brothers? A. I don't recall any offhand because I don't think we have had an Arbitrage transaction in the last few years in which a partner of Lehman Brothers was a director of one of the companies involved.

Q. With respect to the moneys paid to you by Lehman Brothers, how was that arrived at? How was that computed with respect to other matters other than the stock transaction? [160] A. I am not a bookkeeper, but

*Joseph A. Thomas, for Defendants, Cross*

they keep the books and they take in the gross and deduct the expenses and then the interest on capital, and whatever is left is divided up in accordance with the partnership agreement which is entered into at the first of every year and agreed to by all the partners.

Q. And is your contribution to the partnership taken into account when dividing up the profits? A. Do you mean in the capital I have in the firm?

Q. No, in dividing up profits of a transaction, of any transactions, is your contribution to that particular transaction taken into account? A. It would only be taken into account in a specific matter like this one where it was earmarked and waived.

Q. Now— A. I might tell you, Mr. Levy, that we have had a number of transactions in which other partners waived their interests, primarily CAB financing where by law you can't participate.

Q. Where a partner in Lehman Brothers waives his interest in a transaction, is that partner's interest distributed amongst the other partners? [161] A. It is, to my understanding, yes.

The Court: On what basis, mathematic? If you had a 4 per cent interest, for example, and you were entitled to, let's say, \$4,000 on this transaction, and if you waived your interest, how would that be distributed among the other partners? On the basis of 96 per cent?

The Witness: No, sir, it is a simple mathematical transaction. You just let the 96 equal 100. If a fellow had four, he would become 4.02 or something like that.

The Court: I see.

Mr. Levy: So that from what I gather in your testimony, Mr. Thomas, it is entirely possible and it has occurred where directors have waived their interest in short swing profits in corporations in which they were

*Joseph A. Thomas, for Defendants, Cross*

directors and the profits realized on the particular director's part were distributed amongst all the other partners.

The Witness: Yes, it occurred right here.

Mr. Levy: That is all.

Mr. Vance: No questions.

The Court: All right.

(Witness excused.)

[162] The Court: Anything more?

Mr. Vance: Yes, sir, I have a little bit more.

Mr. Levy: While we are waiting, your Honor, I wonder if I could read one question and answer—

The Court: Let's wait until Mr. Vance gets through with his case.

Mr. Vance: Mr. Levy, will you stipulate that the schedule which I am showing you is a true and correct copy of the schedule which was marked for identification during the examination before trial of Mr. Hammerslough from which you have read this morning? The schedule shows the purchase prices of the common shares of Tidewater purchased by Lehmans in 1954 and the sales prices of the preferred shares into which those common shares were converted.

Mr. Levy: I will stipulate that that is a correct copy of that, but I can't see its relevancy and must object to its relevancy with respect to the purchase prices of the common shares.

Mr. Vance: Your Honor, I offer it in evidence.

The Court: Received in evidence. You are simply saying that the purchase price is the [163] date of the conversation.

Mr. Levy: That's right.

The Court: I understand your position. We will take this for what it is worth.



*Colloquy*

(Marked Defendants' Exhibit E in evidence.)

Mr. Vance: Mr. Levy, I will now ask you if you will stipulate that the photostatic copies which I have laid before you are photostatic copies of SEC Form 4s which were marked Plaintiff's Exhibits 1 through 6 during the deposition of Mr. Thomas and that they are photostatic copies of the original documents filed with the SEC on the date indicated on each form.

Mr. Levy: I will so stipulate, but I will object to the writing on them which refers in any way to any waiver of Mr. Thomas' interest in the purchase of shares.

The Court: What do you want to offer them for?

Mr. Vance: I offer them in evidence, your Honor.

The Court: Cumulatively? Is this cumulative evidence?

Mr. Vance: It may be cumulative, your Honor. [164] On the other hand it may not be. I think it perhaps is cumulative.

The Court: For what they are worth I will receive them in evidence as one exhibit.

Mr. Vance: Yes, if you would, please.

(Marked Defendants' Exhibit F in evidence.)

The Court: What is the number of that form?

Mr. Vance: Form 4, your Honor.

Mr. Levy: Do I have my exception, your Honor?

The Court: Yes.

Mr. Levy: Thank you.

Mr. Vance: Mr. Levy, will you stipulate that on October 7, 1954, the board of directors of Tidewater approved a proposed plan of recapitalization which is Exhibit 1 to the proxy statement which I now hand you?

Mr. Levy: I will so stipulate.

Mr. Vance: And will you further stipulate that at a special meeting of stockholders held on No-

*Colloquy*

vember 15, 1954, an amendment to the certificate of incorporation of Tidewater Oil Company was duly adopted which created and authorized the issuance of 6,300,000 shares of the \$1.20 preferred stock of Tidewater?

[165] Mr. Levy: I will so stipulate.

Mr. Vance: Will you also stipulate that at the shareholders meeting of November 15, 1954, a majority of shareholders of Tidewater authorized, approved and consented to the issuance of the \$1.20 preferred stock in exchange for shares of common stock pursuant to the plan of recapitalization and approved such plan of recapitalization, which is Exhibit 1 to the proxy statement dated October 22, 1954?

Mr. Levy: I will so stipulate.

Mr. Vance: Will you also stipulate that an offer of exchange dated October 22, 1954, in accordance with the said plan of recapitalization was duly made by Tidewater to its shareholders?

Mr. Levy: I will so stipulate.

Mr. Vance: Mr. Levy, I show you the following documents, a letter dated October 22nd on the letterhead of Tidewater Associated Oil Company, proxy statement to which we have been referring, and the offer of exchange, and ask you if you will stipulate that these documents were sent to the stockholders of the Tidewater Oil Company.

Mr. Levy: I will so stipulate.

The Court: What difference does it make?

[166] Mr. Vance: I offer them in evidence.

The Court: I know, but he stipulated the essential facts. The particular language of the documents makes no difference at all so far as I can see.

Mr. Vance: If we ever reach the question of when there was a purchase and whether or not conversion



*Colloquy*

constitutes a purchase, that might become important.

The Court: All right. For that limited purpose I will take it. Mark them as one exhibit.

(Marked Defendants' Exhibit G in evidence.)

Mr. Vance: Mr. Levy tells me that his time is running short here with his conference. I may or may not be able to finish up in five minutes.

The Court: You have a conference before Judge McGohey, you say?

Mr. Levy: Yes, sir.

The Court: See if you can finish in five minutes.

Mr. Vance: I will try, your Honor.

The Court: You haven't any more to put in this case, have you?

Mr. Levy: No, sir.

[167] Mr. Vance: Your Honor, I have just looked through this and inasmuch as I see that you have still reserved with respect to Mr. Thomas' possible liability, I am going to have to read from one of the other depositions of a witness who is outside the country. I doubt if I can get it done in five minutes.

The Court: Then why don't we adjourn until tomorrow morning?

Mr. Vance: I would think it would take no more than 15 minutes tomorrow morning.

The Court: And then you will rest?

Mr. Vance: I will rest then your Honor.

The Court: Then we will finish early tomorrow morning. Any briefs you people want to submit I would like to get as soon as possible so I can hand down my final opinion.

We will adjourn until 10:30 tomorrow morning.

(Adjourned to Tuesday, April 28, 1959, at 10:30 A. M.)

## Colloquy

[168]

New York, April 28, 1959, 10.30 a. m.

Mr. Vance: Your Honor, before proceeding I would like to raise a point of clarification which may simplify further proceedings.

I would like to ascertain from the plaintiff whether the plaintiff now claims that the defendant Thomas should be required to account for the profits realized by the other partners of Lehman Brothers, or whether the plaintiff is only claiming that the defendant Thomas should be required to account for what would have been his regular share if he had shared in the profits of the Tidewater transaction.

Mr. Levy: Must I answer that, your Honor?

The Court: Mr. Levy, as I understand it, your complaint seeks all the profits made by the firm of [169] Lehman Brothers, and then in the alternative that if you are not entitled to get that you are entitled to at least get whatever profits Mr. Thomas got.

Mr. Levy: That's right, sir.

The Court: Now, so far as the claim against Lehman Brothers for the profits made by the firm as such, I have said that I will dismiss that claim under the *Ratner* case and the statute, but I have reserved decision so far at least on the question of any profits made by Mr. Thomas.

Now, that raises the question as to whether Mr. Thomas, by executing a waiver—I don't think he executed a waiver but by orally stating that he waived any of the profits thereby ended up with no profits in the transaction. I think that is quite a question.

Mr. Vance: Your Honor, may I ask this question: Under your ruling of yesterday, which as I under-

*Colloquy*

stand it granted a motion to dismiss as to Lehman Brothers and all of the other defendants aside from Thomas, there is still left in the case the issue of whether or not the defendant Thomas could be held liable for the profits which Lehman Brothers and the other partners realized other than [170] the defendant Thomas' ordinary share.

The Court: Well, I suppose technically that is true, but the judgment sought here is against the firm of Lehman Brothers, all of the partners, so much of the cause of action as seeks that I have dismissed. I don't believe that is justified under the statute or under the *Batner* decision but I think the real problem we have here is this, that Mr. Thomas said that he had a 4 per cent interest in the profits of Lehman Brothers. Lehman Brothers made certain profits from this short swing transaction. He, under his partnership agreement, was entitled to a 4 per cent participation approximately in those profits. Mr. Thomas, however, said that he went to the members of the firm and said that he wanted no part in that transaction. He said the other members of the firm agreed that he should have no part in the transaction, informally, at a meeting.

Now, does that mean that he had no profits, or does that mean that he had the profits and gave them up to the members of his firm? I am thinking of it a little bit as analogous to an income tax situation. In an income tax situation if he did that he would have been considered as having the [171] profits and then making a gift of them to somebody else.

Mr. Vance: Your Honor, I understand very clearly that that issue is still in the case but I am still not clear whether or not there is still an

*Colloquy*

issue in the case as to whether or not defendant Thomas can be required to account for the profits which his partners realized.

Now, that was an issue in the *Ratner* case, and the Court there held that he definitely could not be held liable for any profit which his partners realized as a part of the transaction.

The Court: I think the statute makes it clear that it is the profits realized by the director.

Mr. Vance: I believe that is correct, your Honor.

The Court: Any profit realized by him, that is, the director.

Mr. Levy: The question arises as to whether or not a partnership can be disassociated from one of the partners. In other words, the funds of the partners can disassociate themselves from the member partner who is a director. That is one of the issues, too. And, of course, your Honor [172] has heard the evidence that Mr. Thomas testified and Mr. Montblatt testified that he supposedly waived his share of the profits and I believe the amount of the profits which he waived, allegedly waived, has been submitted in evidence by the defendants as amounting to approximately \$31,000 based upon a computation of common stock.

Now, our computation, or the plaintiff's computation demands judgment in the sum of approximately \$99,000 in accordance with the principles laid down by the case of *Parke & Tilford v. Schulte*, so that in any event, even if your Honor finds that the defendant could have waived and is not entitled to return any profits that he didn't receive, he still did receive the balance between \$99,000 and \$31,000.

The Court: The firm did.

Mr. Levy: The firm did, so that his proportionate share would be at least that.

*Deposition of Herman H. Kahn*

The Court: I can understand that. I read the *Parke & Tilford* case again last night and apparently what Mr. Levy says is the measure of damages is the correct one laid down by Judge Clark in that case.

Mr. Vance: Your Honor, I respectfully [173] dissent to that but I believe we are begging the issue that I was trying to get resolved here and that is whether or not Mr. Levy is claiming at this point that Mr. Thomas should be required to account for whatever profit his partners realized.

The Court: Do you so contend?

Mr. Levy: I contend in the alternative that if the Lehman Brothers partners, as your Honor has held, are not responsible, then I say the director is responsible for all the profits or in the alternative for at least his proportionate share of the partnership profits.

The Court: All right. That is the issue then.

Mr. Vance: Your Honor, that being the plaintiff's position I must proceed to put in further evidence.

The Court: All right.

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Mr. Vance: Your Honor, I intend now to read from the deposition of MR. HERMAN H. KAHN, who was a partner of Lehman Brothers and who is presently in Europe. It is dated Monday, September 23, 1957.

"Q. Will you state your name and address, please? A. My name is Herman H. Kahn, 334 Robin Road, [174] Englewood, New Jersey.

"Q. Are you a partner of Lehman Brothers? A. I am.

"Q. How long have you been a partner? A. Since January, 1950.

*Deposition of Herman H. Kahn*

"Q. Were you ever a director of Tidewater? A. No.

"Q. Do you know about the purchase by Lehman Brothers of Tidewater securities commencing October 8, 1954? A. Well, now, going back a period of three years, and I have a pretty firm recollection of what had happened, but I may be a little fuzzy on the percentage details, and I will relate it to you as best I can.

"At that time the company's president, Mr. David Staples, who was successor to Humphreys, had announced—I think he announced that sometime in September—that it was contemplated that the company might create a new dividend-paying security, a preferred stock—I believe he labelled it a preferred stock—to be offered to the company shareholders who wished to make an exchange, who wished to have a cash dividend income from their holdings.

"The company, prior thereto, had abandoned [175] the payment of cash dividends and was paying a stock dividend, and some stockholders were a little unhappy about this turn of events and preferred the cash dividend, and Mr. Staples, the president, announced that such a plan was under contemplation.

"Now, at that time, that announcement, in September, might very well have been construed, as it was by me personally, as the first step in a definite plan of action. The president could not have announced that this was going to be done, as a matter of fact, because he would have been anticipating his own Board of Directors. The proper procedure would be for a president to discuss it with his Board.

"So when he announced it publicly, it was perfectly clear that the next step would then be a discussion and finally a plan of action by the Board of Directors. I am sure that the president would not even dream of making it publicly available, and the news publicly available, unless his thinking were fairly well advanced.

*Deposition of Herman H. Kahn*

"When it was announced we were just about coming out of the summer doldrums, or may have well been in it. Business was rather inactive at the time, and I remember there was some gossip around the office [176] about whether or not it might be a good idea to take advantage of the company's offer.

"No offer concretely had been made, you understand, Mr. Levy, but at that time it was perfectly clear that an offer was seriously contemplated and would be made. Otherwise protocol would have required that it not have gotten as far as the publicity release.

"And at that time I discussed with Marvin Levy, who headed our Sales Department, the general desirability of our taking a position in Tidewater stock. It seemed to me a fairly good open arbitrage as distinct from a closed one, one that contains a certain element of risk because all of the facts are not yet complete.

"There was the possibility, although a remote one, that the plan would not be approved by the Board of Directors and would never be submitted, but it seemed to me that this was what we called a good open arbitrage, that we could buy the common stock and that an offering of preferred would be made which would have to be palatable to the stockholders; otherwise, it would fall by its own weight and would never accomplish its ends. And in order to be acceptable, it would be a preferred stock designated with a good dividend rate as a feature. It therefore seemed [177] to be a good open arbitrage to acquire an open block of stock, either to sell in the market or arbitrage, or to have inventory available for our Sales Department.

"That is where Mr. Levy came into the picture, and Mr. Levy and I discussed it informally.

"There was some other gossip about the matter here, and on an occasion, I recollect Mr. Hammerslough querying me on the subject. Mr. Hammerslough at the time



*Deposition of Herman H. Kahn*

was in charge of our Portfolio Committee, which is a very loose arrangement in Lehman Brothers, and Mr. Glazier had some discussions with me on the subject, but Bill and I, Bill Hammerslough and I, more actively than the others, and then finally with Mr. Levy. And the ball was batted from one of us to the other and then finally on one day Mr. Levy said he thought we ought to start acquiring stock and I said, 'Go ahead.'

"The question was, how much stock. It seemed like a relatively riskless operation and I suggested he go ahead and acquire up to 50,000 shares, and not to worry about it, that I would take the responsibility.

"But I want to emphasize this: The decision to buy the stock was made only after—and this I distinctly remember, even though three years have [178] elapsed—the decision was made only after it was publicly available information, that the directors approved the action, and the company was embarked upon this route.

"By that time many other houses in Wall Street were arbitraging or engaging in the position and accumulation of a position for the open arbitrage. If anything, we were late, and had we moved at the time I wanted to move, which was in September, we would have earned considerably more. As it was, I think we earned only a nominal profit on the transaction.

"Q. Do I understand, Mr. Kahn, that the first indication that you had of the stock being put on the market, or being convertible stock— A. The common was not convertible. The common would have been offered the right to convert into preferred stock.

"Q. The first time you knew about that was when you heard about that from Mr. Staples? A. No. When I read of Mr. Staples' announcement in the newspapers sometime in September. I read the Wall Street Journal, among other papers, rather religiously, from cover to cover.

*Deposition of Herman H. Kahn*

"Q. Did you know how many directors were on the [179] Board of Tidewater at that time? A. I did not know then nor do I know now.

"Q. Did you know that Mr. Thomas was a director of Tidewater? A. Yes, I knew that.

"Q. Did you know that a partner in Kuhn, Loeb was a member of the Board of Directors? A. Yes, I knew that Mr. Schiff was a member of the Board of Directors of Tidewater.

"Q. Did you discuss these matters with any of these gentlemen? A. I would have regarded it as altogether improper to discuss any confidential matter with either of these gentlemen.

"Mr. Gallantz: And therefore you did not?

"The Witness: And I did not.

"A. (Continuing) I might add, in answer to that, that I felt I was entirely capable of arriving at a judgment on my own. Here at Lehman Brothers we have a rather, I would say, loose but highly effective organization. We are not compartmentalized here. I—we all have varying skills. My skills, as regarded by my partners, whether right or wrong, are in the area of pricing securities. I kept in very close touch with [180] the market for senior securities, bonds, private placements, public and otherwise, and with preferred stocks. And at that time I felt that the preferred stock market was—there was a healthy institutional demand for preferred stocks, and this was ideally suited for an open arbitrage.

"I would not have elicited any opinion from my partner, Mr. Thomas, to begin with, because it would have been improper to do so. Aside from that, I felt entirely capable—without disparagement to my partner—I felt I could have arrived at a judgment of a preferred stock deal more accurately than he."

*Deposition of Herman H. Kahn*

Mr. Vance: Your Honor, that is all I have to read from Mr. Kahn's deposition.

The Court: Do you want to read anything from Mr. Kahn's deposition, Mr. Levy?

Mr. Levy: I would like to read page 12 of Mr. Kahn's deposition, question 3:

"Q. Do you know that the present directors of Monterey Oil include two members of the Lehman Brothers firm, Mr. Fell— A. Yes, I know that, Mr. Fell and Mr. Ehrman. I am usually well posted on who in Lehman Brothers is on what company's board."

[181] Now, if your Honor please, before going any further I would like to draw your attention to the testimony of Mr. Kahn on page 7 in which he said—

The Court: Has it been read?

Mr. Levy: Yes—in which he stated—

Mr. Vance: What is the significance then?

Mr. Levy: I want to show that Mr. Gutman—rather, Mr. Hammerslough and Mr. Kahn are in direct conflict as to who gave—

The Court: That is a matter of argument. Let's move on with the testimony.

Mr. Vance: Have you anything further to read from Mr. Kahn's deposition?

Mr. Levy: No, sir.

*Deposition of Joseph A. Thomas*

Mr. Vance: Your Honor, I just have one more excerpt to read from Mr. Thomas' deposition. It is only one question and answer and therefore I don't think it is necessary to have Mr. Carlson read it. This is from page 8 of MR. THOMAS' deposition which was read yesterday. Question 2:

"Q. You mentioned that there was a committee in charge of making purchases and sales of securities on Lehman Brothers account. A. That is right. There is such a committee.

[182] "Q. Prior to the purchase by Lehman Brothers of Tidewater stock did any member of that committee speak to you concerning it? A. No."

The Court: Any more testimony?

Mr. Vance: The defendant rests.

The Court: Both sides rest?

Mr. Levy: If your Honor please, I don't rest at the moment, your Honor. I would just like to ask the defendant to stipulate that as of March 8, 1955, the profits of the firm of Lehman Brothers at that time did not exceed 47.05 per cent of the total profits made by Lehman Brothers for the year 1955.

Mr. Vance: Your Honor, I just don't know what the fact is.

The Court: 47.05 didn't exceed—

Mr. Levy: Of the total profits for the year.

The Court: Profits of what?

Mr. Levy: The total profits made by Lehman Brothers, which was subject to distribution to the partners.

The Court: Didn't exceed what?

Mr. Levy: 47.05 per cent of the total profits made by Lehman Brothers during the year 1955.

[183] The Court: Now wait a minute. That is inconsistent. You say the profits didn't exceed the profits.

*Colloquy*

Mr. Levy: No, I say the total profits, the profits realized by Lehman Brothers up to March 8, 1955, which were subject to distribution to all the partners, all the general partners, did not exceed 47.05 per cent of the total profits made by Lehman Brothers for the entire year.

The Court: Well, of course, I don't know how Lehman Brothers distributes their profits. Maybe they distribute them on an annual basis, so I don't know that the profits of the three months makes any difference there.

Mr. Levy: The only reason I suggest—

The Court: There is no proof as to how they distribute their profits.

Mr. Levy: The only reason I suggest that, your Honor, is that it has been testified that Mr. Thomas receives 4 per cent of the first 47.05 per cent of the profits.

The Court: All right.

Mr. Levy: Now, the first 47.05 I assume is what has been made up to a certain period, up to [184] a certain time.

The Court: Up to the time the 47 per cent of the profits, I suppose they do it on some regular accounting basis, either annually or monthly or something like that. I don't know. There has been no testimony on that. But I am ready to assume, Mr. Vance, that the profits, whatever they were, on this Tidewater stock, did not exceed 47-1/2 per cent of the profits of Lehman Brothers. In other words, that Mr. Thomas' 4 per cent rather than this one point-something-or-other per cent would be applicable to those profits.

Mr. Vance: Your Honor, I don't know what the profits of Lehman Brothers were as a total by March of 1955.

The Court: I don't either.

Mr. Vance: On the other hand, as I understand it, for every dollar that comes in there is a distribution on the basis which was outlined yesterday.

The Court: How do they know what the profits are until they have some accounting period?

*Colloquy*

Mr. Vance: I don't know what their accounting period is.

The Court: There has been no proof of that.

Mr. Vance: That's correct.

[185] The Court: Therefore I assume that is profits he was entitled to. It would be up to him to show the accounting period to make the difference. Back in 1929, for example, Lehman Brothers made a lot of profits in the first three months of the year, but if they had an annual accounting basis of profits probably by the end of the year they ended up with a deficit like most investment firms did, but in the absence of any proof I will take it that he was entitled to 4 per cent of the profits.

Mr. Vance: Your Honor, I can't see what difference it makes whether or not Lehman Brothers, by March 8, had earned 47 per cent of the total profits that they earned during the year 1955.

The Court: I don't either.

Mr. Vance: Therefore, I can't stipulate it.

The Court: I am just telling you that I am going to assume that the 4 per cent bracket of Mr. Thomas' agreement is applicable to this in the absence of other proof.

Mr. Vance: Yes.

Mr. Levy: The plaintiff rests, your Honor.

Mr. Vance: I think the schedules which were offered and not received in evidence yesterday, your [186] Honor, show the way that the computations were made on this particular transaction which is in issue.

The Court: Those schedules showed that they allocated the profit to the other partners of the firm.

Mr. Vance: That's correct, your Honor.

The Court: And they also showed that the cost price was the cost of the common stocks which were originally bought. I don't believe that those schedules made by this assistant comptroller are necessarily conclusive.

*Colloquy*

Mr. Vance: They are made in the ordinary course of business. That is his regular duty to do it and he so testified.

The Court: Well, you are now talking about Exhibit C for identification I take it.

Mr. Vance: I believe it was C and D.

The Court: C and D. Do you want them put in evidence? Do you really feel that they should go in evidence?

Mr. Vance: I think so.

The Court: I will reverse my ruling and put them in evidence.

Mr. Levy: Of course I object to that.

[187] The Court: They are documents compiled in the regular course of business. I don't think they mean very much. But if you want them as part of the record to talk about them, all right.

(Defendants' Exhibits C and D received in evidence.)

The Court: Both sides rest, then.

Mr. Vance: Yes, sir.

Mr. Levy: Yes, your Honor.

Mr. Vance: Your Honor, at this point I would like to renew my motion to dismiss with respect to the defendant Thomas, and to move for judgment dismissing the claim that Thomas be required to account for what he normally, what normally would have been his share of the profits realized in the Tidewater transaction.

Not only has the plaintiff failed to show that he realized any profit, but the evidence shows conclusively that he did not. What is that evidence? Mr. Thomas testified yesterday that immediately upon hearing about the purchase of Tidewater stock he went to the senior partner of the firm, Mr. Lehman, and told him that he wanted to disassociate himself in every way possible from the transaction, either in [188] putting his money at risk, in running the risk of loss, or in sharing any profits.



*Colloquy*

The Court: Let me ask you this, Mr. Vance: Suppose that thereafter they had made a commitment to buy this Tidewater stock, and that Lehman Brothers went into bankruptcy, do you mean to say that Mr. Thomas's capital would not have been at risk in that transaction because he had made that statement to a partner of his?

Mr. Vance: Your Honor, I have not researched that. It might be possible that it might not, but—

The Court: Well, his capital was part of the assets of the firm and held out as such to the public. I don't believe that if a creditor sued Lehman Brothers after that, that Mr. Thomas could say, "Oh, no, my capital, I had a side understanding with my senior partner that that wouldn't be at risk"?

Mr. Vance: But the crucial thing is whether or not he realized any profit.

The Court: I think the same thing is true on the profit.

Mr. Vance: Well, now, if you can remember what he did, your Honor. He testified that he then went to the treasurer of Lehman Brothers and [189] said, "Take appropriate action so that I will not get any part of the profit which may be realized on this transaction." Such steps were taken in the treasurer's office and no part of the profit was allocated to him. The Form 4s which were filed waived any right.

The Court: What does that mean other than that he was entitled to a profit and he said, "I will give it to my partners"?

Mr. Vance: Well, your Honor, just one more thing. He also testified that he went to the partners meeting and he told them that he waived any right to share in the profits of the transaction and that they agreed. Now, perhaps that was an amendment *pro tanto* of the partnership agreement with respect to this transaction.

The Court: It was an oral statement made by him. It isn't a formal amendment to the partnership agreement.

*Colloquy*

Mr. Vance: In any event, your Honor, he didn't realize any profit from the transaction.

The Court: He didn't take any profit, but did he realize it without taking it? That is the question.

Mr. Vance: Your Honor, we respectfully submit [190] that he did not realize any even without taking it.

Secondly, your Honor, I move for judgment dismissing the claim that Thomas be required to account for any profit which his partners may have realized in this transaction.

Now, on that I think the law is clear under the *Ratner* case, your Honor, that very issue was up. Whether or not Mr. Hertz in that case should be required to account for the profit which his partners had realized in the sale, purchase and sale of Consolidated Vultee stock. The Court of Appeals for the Second Circuit held that he could not be liable. Now, it is true that they went on in dictum there and said, "Whether the result might have been different had he caused the firm to make the purchases we need not now determine."

However, even applying that test, there is not a shred of evidence in this record which indicated that he caused or had any connection with the purchase—

The Court: I am inclined to agree with you that that proof does not indicate that he caused the purchase by Lehman Brothers of this stock. Whether it would be different if he had caused it is something which Judge Hand seemed to be somewhat in doubt about [191] and I would be in doubt about, but I don't believe that he did cause it to be made on the evidence here.

Now, I take it that the *Ratner* case means that the partnership as such, which is the other partners, are not responsible for the profits under those circumstances. That is my present inclination in the case. The one doubt I have in my mind is whether the director himself, if he realized a profit, and that is a question of fact, re-

*Colloquy*

alized it through the partnership, may be required to account for that profit realized by him through his partnership. I can visualize a situation where a man, let us say, has one other partner. He is a director of a company, and he goes on the board, and the partnership buys securities and sells securities in a company of which he is a director, and in that situation it seems to me that the statute would say that he had realized profits on that. I don't think it makes any difference that it is a big partnership rather than a small partnership.

Now, that is my present thinking.

Now, whether he realized profits here is, of course, a question of what you mean by "realized." Can a person disassociate himself from the profits [192] and simply say, "Well, I don't want those profits any more," and say, "Well, I didn't realize them." From an income tax standpoint I don't think you can do that. I may be wrong. I am not an income tax lawyer. Somebody gets some income and then simply says, "I don't want them, give them to somebody else," the income tax people say "It was yours, you made a profit, you made a gift of them, and you must pay a gift tax too." Maybe that is the situation here.

But I think it is an interesting question of law, and it is sufficiently important that I presume that I should write an opinion on it, not necessarily for this case but because it may be important in other cases where this question comes up.

I am, therefore, going to reserve decision on it and give each of you an opportunity to file briefs, and write an opinion on the subject.

Mr. Vance: Your Honor, may I ask one question? Are you also reserving decision on whether or not Thomas can be held accountable for the profits that his partners realized, or are you ruling on that motion?

*Colloquy*

**The Court:** I am reserving decision on it, but my thinking is that it is the same thing as to [193] whether Lehman Brothers is liable.

**Mr. Vance:** I think it is exactly the same, your Honor.

**The Court:** And that is why technically I am reserving decision on it.

**Mr. Vance:** Right.

**Mr. Levy:** I was going to say, your Honor, that the facts in the Ratner case were different than they are here in that no testimony had been taken of any of the partners of Lehman Brothers, no testimony or evidence had been shown that any of the partners had spoken to the director concerning the affairs of the corporation upon which that particular director-partner was a member, while in this case we have direct testimony that at least five or six of the general partners of Lehman Brothers, including the person who actually gave the order to buy the securities, Mr. Hammerslough, had spoken to Mr. Thomas concerning the affairs of Tidewater.

**The Court:** But not about the proposed change in the capital structure.

**Mr. Levy:** No, sir, but about the general affairs of Tidewater. In order to purchase stock, your Honor—  
[194] **The Court:** This statute is for the purpose of preventing the unfair use of information. Now, there is no indication here that there was any unfair use of information in connection with this transaction. The testimony was complete that the announcement of the proposed issuance of a dividend-paying stock and the proposed conversion of common into that stock came out in the Wall Street Journal in September. That the first discussions of the partners of Lehman Brothers took place after that came out; that they didn't decide to buy it until a later announcement came out in the Wall Street Journal on October 8th, I think it was, saying that the board of directors had approved the plan subject to a subsequent meeting of the stockholders.

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*Colloquy*

Now, there is nothing there that you and I, Mr. Levy, wouldn't have known about.

Mr. Levy: Well, your Honor, of course I suppose I ought to reserve it for my brief, but in the case of *Newman v. Ashland Oil Company*, decided in the Sixth Circuit in Ohio, and in an opinion written by Judge Potter Stewart, who is present in the Supreme Court, he stated that where there is any possibility—

[195] The Court: Is he there or is he still on the anxious seat?

Mr. Levy: I think he has been confirmed.

The Court: I saw the Senate Committee approved him, but I didn't know that they voted on it.

Mr. Levy: He has made the statement that where there is any possibility of use of inside information, the insider must be held. As a matter of fact, the statute itself, Section 16(b) particularly states that although the insider may have no intention whatsoever of using inside information, as a matter of fact the courts in this district and in other districts have construed that section that even though he may never have made use of such inside information—

The Court: This is a definite statute and whether he uses inside information or not, if certain events take place within a certain period of time, the director is liable.

Mr. Levy: That's right.

The Court: That is why I think the statute has to be definitely construed as confined to the director and not to the partnership because it might be contended that the partnership benefited by inside information and should account. That is what I talked [196] about yesterday as possibly a common law, but you are not relying upon that, you are relying upon the statute.

*Colloquy*

Now, I don't think that Judge Stewart or Mr. Justice Stewart, if he has now been confirmed, is doing anything more than stating what the statute states.

Mr. Vance: I think that is correct, your Honor. If your Honor will read the case, that is exactly correct.

Mr. Levy: I would like to submit a brief on these points, your Honor.

The Court: When can you get your briefs in?

Mr. Vance: Your Honor, one point I will also perhaps want to brief further is the point that we briefed very slightly in our pretrial memorandum and that is the question of whether or not there in fact was a purchase at the time of conversion. It is our position that there was not a purchase at that time.

The Court: Cover that also. That, I think, you have the problem of running up against Judge Clark's opinion in the Shulte case or something like that.

Mr. Vance: Yes, but I think that that [197] has subsequently been clarified in *Roberts v. Eaton* in this circuit.

Your Honor, I would think that we could get it in within a week, if that is all right.

The Court: All right. That is all right with me.

Mr. Levy: That is all right with me, too.

The Court: Say a week from today. Today is Tuesday. Do you want to file it next Tuesday then?

Mr. Vance: Yes, sir, that would be fine.

The Court: That gives you the week end to work on it.

Mr. Vance: Thank you, your Honor.

The Court: All right, decision is reserved.

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**Opinion.****DAWSON, D. J.:**

This is an action based upon §16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A. §78p(b),\* in which plaintiff, a shareholder of defendant Tide Water [270] Associated Oil Company (hereinafter called "Tide Water"), seeks an accounting by defendants other than Tide Water of certain profits realized from alleged purchases and sales of securities within a period of less than six months.

This action was tried by the Court without a jury and the following are the findings of fact of the Court.

At all material times the securities of defendant Tide Water were registered on the New York Stock Exchange. Defendant Joseph A. Thomas was, at the time of the transactions here involved, a director of Tide Water and also a member of a partnership doing business as Lehman Brothers. In 1954 under the partnership agreement Thomas was entitled to receive 4% of the first 47.05% of the profits and 1.85% of the remaining 52.95%

\* Section 16(b) reads as follows:

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."



*Opinion*

of the profits. In 1955 he was entitled to receive 4% of the first 44.05% of the profits, plus 1.85% of the remaining 55.95%.

In 1954, at the age of 76, defendant John Hertz, then a partner of Lehman Brothers, resigned his directorship of Tide Water. After resigning he spoke with Mr. Staples, President of Tide Water, and recommended defendant Thomas as a prospective director of Tide Water. Hertz then asked Thomas whether he would like to become a director of Tide Water and Thomas said that he would. Mr. Thomas was then introduced to Mr. Staples at the home of John Schiff, a friend of Mr. Thomas and a partner of Kuhn, Loeb & Company. [271] Staples and Thomas then met several times, culminating in Staples asking Thomas if he would like to be a director. The invitation to join the Tide Water Board was upon the initiative of Tide Water. Thomas accepted the directorship because of his interest in the oil business and because of the prestige factor in serving on the Board of a large corporation.

Between October 8, 1954 and November 15, 1954, the partnership, Lehman Brothers, purchased in the regular course of its business 50,000 shares of Tide Water common stock at an aggregate cost of \$1,330,800. The purchase of these shares by Lehman Brothers was made at the direction of the partners constituting the investment committee of the firm, of which Thomas was not a member, and he was not consulted by his partners as to the proposed plan of recapitalization of Tide Water, or with reference to any of the affairs of Tide Water, except to say to them that he believed it was a good company under good management. The Court finds as a fact that the stock of Tide Water was bought and sold by Lehman Brothers without any advice or concurrence of Thomas, or without his knowledge until after the transactions had taken place.

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Pursuant to a plan of recapitalization, Lehman Brothers exchanged its 50,000 shares of common stock on December 8, 1954 for 50,000 shares of a new preferred stock [272] issued by Tide Water. Between December 9, 1954 and March 8, 1955, Lehman Brothers sold its 50,000 shares of preferred stock realizing in the aggregate the sum of \$1,361,186.77. Lehman Brothers' purchases of Tide Water common stock were made upon the basis of two articles published in the Wall Street Journal. The first of these articles appeared on September 17, 1954. In it Tide Water announced that it was considering a proposal to allow shareholders to exchange common stock for a new dividend-paying preferred stock. On October 8, 1954 a second article appeared in the Wall Street Journal which announced that the Tide Water board of directors had approved plan of recapitalization under which it proposed to create an issue of \$1.20 dividend cumulative preferred stock and under which plan all holders of its common stock could exchange their common stock on a share-for-share basis for the new dividend-paying cumulative preferred stock.

Beginning on October 8, 1954, after the plan of recapitalization had been approved by the Tide Water board and had become public information, Lehman Brothers, planning to convert Tide Water common into Tide Water preferred, and acting solely on the basis of Tide Water's public announcements and without consulting Thomas with reference thereto, purchased the 50,000 shares of Tide Water common stock which were exchanged for an equal number of shares of the newly [273] issued preferred stock on December 8, 1954. By March 9, 1955 Lehman Brothers had sold all the preferred stock.

Joseph A. Thomas, who had served as a director of Tide Water since August 5, 1954, from the outset completely revealed the firm's transactions just described by filing monthly statements with the Securities and Ex-

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change Commission for October, November and December, 1954 and January, February and March, 1955.

When Thomas learned that his firm had purchased shares of stock in Tide Water, of which he was then a director, he orally indicated to his partners that he wished to be disassociated with the transaction and that he waived his interest in it. According to his testimony he made this statement at a meeting of partners and his partners acquiesced. Later, when the transaction was completed by the sale of the Tide Water stock, a statement was prepared by the Comptroller of the firm showing the profits made by Lehman Brothers on the transaction, but no share of the profits was shown as attributable to Thomas and what otherwise would have been his share of the profits was allocated to the other members of the firm.

Plaintiff, a stockholder of Tide Water, through his attorney, sent a letter on June 29, 1955, pursuant to §16(b), requesting Tide Water to institute suit against defendants Lehman Brothers and Thomas to recover profits [274] realized in the above transaction. Further, plaintiff allowed more than sixty (60) days to elapse after making the demand, and when Tide Water failed to bring the suit plaintiff brought this action.

The law is now well settled that the mere fact that a partner in Lehman Brothers was a director of Tide Water, at the time that Lehman Brothers had this short swing transaction in the stock of Tide Water, is not sufficient to make the partnership liable for the profits thereon, and that Thomas could not be held liable for the profits realized by the other partners from the firm's short swing transactions. *Rattner v. Lehman Brothers*, 193 F. 2d 564, 565 (2d Cir. 1952). This precise question was passed upon in the *Rattner* decision. Judge L. Hand, in a concurring opinion in the case, said that he wished to say nothing as to "whether, if a firm deputed a partner to represent its interest as a director on the

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board, the other partners would not be liable." In this case there was no evidence that the firm of Lehman Brothers deputed Thomas to represent its interests as director on the board of Tide Water; in fact, the interests of Lehman Brothers in Tide Water at the time Thomas was elected to be director were minimal.

In the *Rattner* case the partner of Lehman Brothers who was a director of the corporation whose shares had been involved, realized \$806.62 profit from the transaction and he paid the money over to the corporation. Thomas has [275] paid nothing over to Tide Water. The Court dismissed the instant action as to Lehman Brothers on the authority of the *Rattner* decision, leaving open, however, the question as to whether Thomas individually might be liable for his share of the profits on the short swing transaction.

The basic question which this Court must decide on this issue is whether an insider-partner *realizes* profits within the meaning of §16(b), and is liable therefore, if he orally waives receipt of his share of the profits made by the partnership in "short swing" transactions of his corporation's securities.

Section 16(b) of the Securities Exchange Act of 1934 provides that all profits "realized" by an officer or director of a corporation from short term trading in its securities shall inure to the corporation. The purpose of the statute is to prevent, in short term trading in its securities, the possible unfair use of information which may have been obtained by an officer or director of the corporation by reason of his position. One of the purposes of §16(b) was to prevent questionable transactions between insiders among themselves to the possible detriment of the minority shareholders and the public in general.

In *Kogan v. Schulte*, 61 F. Supp. 604, 609 (S. D., N. Y., 1945), *aff'd sub. nom. Park & Tilford, Inc., v. Schulte*, 160 F. 2d 984 (2d Cir. 1947), the Court stated:

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[276] "We must not lose sight of the purposes of the statute. Judge Clark in *Smolowe v. Delendo Corporation*, *supra*, gives us a standard of interpretation which is applicable to the facts of the present case. He states (136 F. 2d at page 239): 'The statute is broadly remedial. Cf. *Wright v. Securities and Exchange Commission*, 2 Cir. 112 F. 2d 89. Recovery runs not to the stockholder, but to the corporation. We must suppose that the statute was intended to be thorough-going, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty. Cf. *Woods v. City Nat. Bank & Trust Co. of Chicago*, 312 U. S. 262, 61 S. Ct. 493, 85 L. Ed. 820; *In re Mountain States Power Co.*, 3 Cir. 118 F. 2d 405; *Otis & Co. v. Insurance Bldg. Corp.*, 1 Cir. 110 F. 2d 333; *In re Republic Gas Corp.*, D. C. S. D., N. Y., 35 F. Supp. 300.'"

In the instant case we have a situation where liability of Thomas would be clear if Thomas had taken his share of the profits. Did he, by oral waiver and transfer of his profits to other partners, insulate himself against liability under §16(b)? The primary question is whether or not the defendant Thomas "realized" a profit within the meaning of the statute and is therefore liable. The legislative history is not very helpful on this problem. There is no guide to the meaning of the phrase "profit realized by him." Ordinarily there is no difficulty in ascertaining who realized the profit; it is the person for whose account the purchases and sales are made. Thus in the case of trading done for the account [277] of a partnership, one of whose members is an insider of the corporation whose stock was traded, the profit is realized and re-

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covery allowed to the extent of the insider's proportionate partnership interest, rather than the full profit of the partnership. Cook and Feldman, *Insider Trading Under the Securities Exchange Act*, 66 Harv. L. Rev. 612, 628 (1953).

For the reasons set forth below, this Court feels that Thomas must still be held liable for what would have been his proportionate share of the partnership profits.

An insider-partner has at all times a beneficial interest in the purchase of all securities of the partnership and must report such ownership under §16(a); and also must account for any profits from a sale thereof within six months. Rubin and Feldman, *Statutory Inhibitions Upon Unfair Use of Corporate Information by Insiders*, 95 U. P. A. L. Rev. 468, 488 (1947).

Thomas admittedly was a partner of Lehman Brothers when the Tide Water stock was acquired and when it was sold. His capital was certainly at risk in the transaction; he could not, by any declaration of waiver, alter this situation. When the transaction ended with a profit to Lehman Brothers, that profit, so far as Thomas was concerned, did not belong to him. Under §16(b) it belonged to Tide Water. He could not, by a personal waiver of his profits, deprive Tide Water of what belonged to it. If his waiver was effective to transfer [278] his share of the profits to his partners, then it is clear that by making such transfer of profits he was disposing of profits and to that extent he "realized" the profits.\*

\* For taxation purposes income has been held to be "realized" when it is made subject to the will and control of the taxpayer, and could be, except for his own action or inaction, reduced to actual possession. *Loose v. United States*, 74 F. 2d 147, 150 (8th Cir. 1934). See also, *Helvering v. Horst*, 311 U. S. 112 (1940), wherein realization of income was defined as the power to procure payment to another.

Money, property or profits "realized" usually means brought into possession and is usually used in contrast to hope or anticipation, but it need not be cash in hand to be "realized." *U. S. Smelting, Refining & Mining Co. v. Haynes*, 176 P. 2d 622 (Utah 1947). See also, *Lorillard v. Silver*, 36 N. Y. 578, 579 (1867).



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To permit a partner to waive the cash receipt of his partnership share and thereby escape liability is to create a situation which would frustrate the remedial purpose of §16(b). It would permit avoidance of the statute by insider-partners of the same partnership but of different directorships by allowing them to interchange inside information and then waive the receipt of their share. This would result in each partner at varying times benefiting from this mutual waiver. An authority has ably stated what should be the rule:

"A partner should not be able to avoid the status of a beneficial owner by merely renouncing his interest in any profit from the transaction." Loss, Securities Regulation, 585 (1951).

The Court concludes that Thomas is accountable to Tide Water for his proportionate share of the profits of Lehman Brothers in the short swing transaction in Tide Water stock. The Court concludes that the profits of Lehman Brothers on this transaction were \$98,686.77.\* Since Thomas' share of the profits, under the partnership agreement, varied with the particular years in which the profit was realized and apparently did not depend on the profits from an individual transaction, but rather with respect to the entire profits of the partnership, the evidence is not sufficient to determine with accuracy the amount "realized" by Thomas. If the parties cannot agree upon

\* The cost of the shares to Lehman Brothers must be determined as the lowest price at which Tide Water common stock was selling at the time the common stock was converted into preferred stock, for this conversion constituted the purchase. *Park & Tilford, Inc., v. Schulte*, 160 F. 2d 984 (2d Cir. 1947); *Smolowe v. Delendo Corp.*, 136 F. 2d 231 (2d Cir. 1943), cert. denied 320 U. S. 751 (1943); *Gratz v. Claghton*, 187 F. 2d 46 (2d Cir. 1951), cert. denied 341 U. S. 920 (1951). The lowest price at which the stock was selling on the conversion date was \$25.25 per share, which would mean that the aggregate purchase price for the 50,000 shares was \$1,262,500. Within six months the converted shares were sold for an aggregate price of \$1,361,186.77. The profit was therefore \$98,686.77.



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this figure, it will be necessary to refer this item of damages to a special master to take and state the account.

Submit decree in accordance with this opinion.

Dated: New York, N. Y. May 22, 1959

ARCHIE DAWSON  
U. S. D. J.

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**Judgment.**

The issues in the above-entitled action having been brought on regularly for trial before the Hon. Archie O. Dawson without a jury on April 27 and April 28, 1959 and the Court having considered the evidence and the arguments and having filed its opinion, findings of fact and conclusions of law; it is hereby

Ordered, Adjudged And Decreed, that defendant, Tidewater Oil Company, have judgment against defendant Joseph A. Thomas for the sum of \$3,893.41, together with costs as taxed in the sum of \$297.40; and it is further

Ordered, Adjudged And Decreed that the action be, and the same hereby is, dismissed on the merits as to defendants Robert Lehman, Allan S. Lehman, John Hertz, John M. Hancock, Monroe C. Gutman, Paul M. Mazur, William J. Hammerslough, Francis A. Callery, Frederick L. Ehrman, John R. Fell, William S. Glazier, Phillip H. Isles, Herman H. Kahn, Edwin L. Kennedy, Frank J. Manheim, Paul E. Manheim, Morris Natelson, Harold J. Szold and Joseph A. Thomas, a co-partnership doing business under the firm name and style of Lehman Brothers; and it is further

[285] Ordered, Adjudged And Decreed, that the defendant, Tidewater Oil Company, pay to Morris J. Levy, Esq., attorney for the plaintiff herein, such reasonable counsel fee for his legal services rendered herein plus his disbursements incurred as the Court may allow upon his application therefor; and it is further

*Judgment*

Ordered, Adjudged And Decreed, that the jurisdiction of the parties and the action herein is retained by this Court for the purpose of the application by plaintiff's attorney for an allowance of his counsel fees and disbursements.

Dated: New York, N. Y., June 25, 1959.

ARCHIE DAWSON  
U. S. D. J.

Judgment entered 6/25/59  
Herbert A. Charlson  
Clerk

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**Notice of Appeal.****Sirs:**

Please Take Notice that Isadore Blau, plaintiff above named, hereby appeals to the United States Court of Appeals for the Second Circuit, from only those parts of the Judgment entered in this action on the 25th day of June, 1959, which (1) dismissed the action on the merits as against defendants, Robert Lehman, Allan S. Lehman, John Hertz, John M. Hancock, Monroe C. Gutman, Paul M. Mazur, William J. Hammerslough, Francis A. Callery, Frederick L. Ehrman, John R. Fell, William S. Glazier, Philip H. Isles, Herman H. Kahn, Edwin L. Kennedy, Frank J. Manheim, Paul E. Manheim, Morris Natelson, Harold J. Szold and Joseph A. Thomas, a co-partnership doing business under the firm name and style of Lehman Brothers; and (2) granted judgment against defendant, Joseph A. Thomas in the sum of only \$3,893.41, and said plaintiff hereby appeals from those parts of said Judgment only.

Dated: New York, N. Y., July 15, 1959.

Yours, etc.,

**MORRIS J. LEVY**  
Attorney for plaintiff

**To:**

Simpson, Thacher & Bartlett, Esqs.  
Attorneys for defendants,  
other than Tide Water Oil Company

Hecht, Hadfield, Farbach & McAlpin, Esqs.  
Attorneys for defendant, Tide Water Oil Company

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**Notice of Cross-Appeal.**

**Sirs:**

Please Take Notice that Joseph A. Thomas, one of the defendants above-named, hereby cross-appeals to the United States Court of Appeals for the Second Circuit from that part of the final judgment entered in this action on June 25, 1959, in favor of defendant Tide Water Oil Company and against defendant Joseph A. Thomas.

Dated: New York, New York, July 20, 1959.

Yours, etc.,

**SIMPSON, THACHER & BARTLETT,**  
Attorneys for Defendants other  
than Tide Water Oil Company,

**To:**

**Morris J. Levy, Esq.,**  
Attorney for Plaintiff,

**Messrs. Hecht, Hadfield, Farbach & McAlpin,**  
Attorneys for Defendant Tide Water Oil Company,

**Defendants' Exhibit A.**

Wall Street Journal Sept. 17, 1954

**Tide Water Oil May Issue Preferred for Part of  
Outstanding Common**

**By a Wall Street Journal Staff Reporter**

Los Angeles—Tide Water Associated Oil Co. is considering a proposal to let shareholders exchange part of their stock for a "regular cash-dividend-paying stock."

David T. Staples, president, said the board of directors at a meeting September 2 discussed informally the possibility of making available preferred stock in exchange for "a portion" of the outstanding common.

He explained that "since the board decided to use for modernization and expansion all cash income reasonably available, Tide Water management has explored means by which stockholders who require cash income might be given an opportunity to exchange their stock for a regular cash-dividend-paying stock."

Tide Water has not had any preferred stock outstanding since 1950. It has not paid a cash dividend on the common since last March, when a 25-cent quarterly payment was made. A 5% stock dividend was disbursed in June, with the explanation the company needed its cash for corporate purposes. Mr. Staples told the Petroleum Press Club here, when he stated the plan for a new preferred was being considered, that there is a "tremendous demand" for cash to finance expansion of refinery facilities on both the Pacific and Atlantic coasts as well as a "very substantial" expansion of marketing facilities and an active exploration program.

**Defendants' Exhibit B.**

Wall Street Journal Oct. 8th 1954

**Tide Water Associated Oil Plans to Issue \$1.20 Preferred Stock****Under Recapitalization Plan Holders Could Exchange Common For New Issue**

**San Francisco** — Tide Water Associated Oil Co. directors approved a plan of recapitalization under which it proposes creating an issue of \$1.20 dividend cumulative preferred stock of \$25 par value.

Holdes of outstanding common stock, other than Mission Development Co., Mission Corp. and Pacific Western Corp., would have an opportunity to surrender all or any part of their common shares in exchange for the new preferred on a share-for-share basis. The three corporations named own together about 53% of the common stock.

A stockholders' meeting has been called for November 15 to vote on the plan and on necessary changes in the certificate of incorporation. It is expected the exchange offer will be submitted to stockholders about October 22 along with notice of the meeting. Its adoption will be conditioned on obtaining necessary approval at the November 15 meeting.

D. T. Staples, president of Tide Water, explained the company's extensive program of capital expenditures has made it advisable to pay cash dividends during the second and third quarters and made it unlikely that any significant cash dividends will be paid for some time. A 5% stock dividend was paid in June.

While most stockholders appear content to forego cash dividends in the interest of capital growth, some have evidenced a desire to receive cash dividends no smaller than those paid before, Mr. Staples said.



*Sale Mfg*  
1400 Tishameter Avenue, Cal 122 N.H.  
*Melchior Joseph A. Thomas*  
1968-28.

		Jan. Exp. 1911		Feb. 1911 by 1911		Total
		No.	\$	No.	\$	
Robert Johnson				4225	25 -	288 -
John D. Smith				567	21 50	31 50
John D. Smith	500	4793		377	21 00	69 00
Harvey C. Smith				672	32 15	35 15
Paul B. Smith	500	11 49		506	32 19	16 00
William J. Thompson	900	16 35		209	13 85	52 20
Frederick A. Hallway				53	2 95	2 95
Frederick A. Smith	400	38 35		565	31 65	70 -
John D. Smith	850	49 14		101	7 29	50 43
William J. Smith	120	15 76		508	28 26	57 02
William J. Smith				950	12 84	52 90
Harvey C. Smith	300	28 76		100	8 17	37 30
John D. Smith	205	21 57		+	-	21 57
John D. Smith	250	21 97		53	2 95	26 92
John D. Smith	400	12 15		732	10 24	50 39
Harvey C. Smith	250	23 97		105	8 00	32 97
Harvey C. Smith	300	26 00		800	17 15	43 15
Joseph A. Smith	(400)			(100)	-	-
	4225			10000		
	- 400			105		
	4325	91272		90 15	90 93	20065
Profit				100 72		
Loss 10 50				100 00		
Jan. Capital 10 50				90 65		
Profit 10 50				90 72		
				90 93		

Salon Dept  
Tidewater Assoc. Oct 6 7:20 PM  
Eschberg Joseph C Thru

[illegible]

23

<u>Trade Date</u>	<u>Shares Purchased</u>	<u>Price</u>	<u>Cost</u>
10/8/54	2600	26-1/4	68,334.50
	4800	26-1/2	127,356.--
	100	26-3/8	2,640.75
	900	26-5/8	23,991.75
	500	26-5/8	13,328.75
	1600	26-3/4	42,852.--
	1100	26-7/8	29,598.25
	5000	27-----	135,162.50
	2100	27-----	56,768.25
	1300	27-----	35,142.25
10/12/54	1000	26-1/2	26,532.50
	1000	26-3/8	26,407.50
10/13/54	500	26-1/2	13,266.25
10/14/54	600	26-5/8	15,994.50
	100	26-3/4	2,678.25
	100	26-3/4	2,678.25
	500	26-3/4	13,391.25
10/15/54	100	26-5/8	2,665.75
10/22/54	1300	26-5/8	34,654.75
	600	26-5/8	15,994.50
10/25/54	1000	26-1/2	26,532.50
	200	26-3/8	5,281.50
10/26/54	400	26-1/4	10,513.--
	800	26-3/8	21,126.--
	600	26-1/4	15,769.50
	200	26-1/8	5,231.50
	300	26-----	7,809.75
10/27/54	300	26-1/8	7,847.25
	400	26-1/8	10,463.--
	1000	26-----	26,032.50
10/29/54	500	26-3/8	13,203.75
	500	26-3/8	13,203.75
11/1/54	1000	26-1/4	26,282.50
	100	26-1/8	2,615.75
11/3/54	500	26-1/2	13,266.25
	500	26-1/2	13,266.25
11/4/54	500	26-1/2	13,266.25
	500	26-3/8	13,203.75
	200	26-1/4	5,256.50
	200	26-1/4	5,256.50
	100	26-1/4	2,628.25
11/5/54	700	26-1/4	18,397.75
	500	26-3/8	13,203.75
11/8/54	500	26-3/8	13,203.75
	500	26-1/2	13,266.25
	1500	26-1/2	39,798.75
11/9/54	2000	26-1/2	53,065.--

<u>Trade Date</u>	<u>Shares Purchased</u>	<u>Price</u>	<u>Cost</u>
11/9/54	600	26-3/8	15,844.50
	100	26-3/8	2,640.75
11/10/54	1000	26-3/8	26,407.50
	1000	26-1/2	26,532.50
	1000	26-1/2	26,532.50
11/11/54	500	26-3/4	13,391.25
11/12/54	500	26-3/4	13,391.25
11/15/54	<u>4000</u>	<u>26-7/8</u>	<u>107,630.--</u>
	50,000 shares		\$1,330,800.--

12/8/54

50,000 Com. Held in Exch. for \$1.20  
Cumulative Preferred

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FORM 4  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON 25, D. C.

The relation of the undersigned to the issuer is that of

DIRECTOR

IDENTIFICATION OF SECURITY (Such as Class "A" Common Stock, 80 Preferred Stock, etc.)	The following changes (whether by purchase, sale, ex- change, gift, or otherwise) in the amounts of equity securities of the above issuer owned by the undersigned occurred during the calendar month named above. (Report each transaction separately)			The undersigned owned directly or indirectly as beneficial owner, at the close of the calendar month named above, the following amounts of equity securities of the above issuer	
	DATE OF TRANS- ACTION	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT		NATURE OF OWNERSHIP (Whether direct or through hold- ing company, partnership, etc.)	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT OWNED AT CLOSE OF MONTH NAMED ABOVE
		BOUGHT (If otherwise ac- quired, so indicate)	SOLD (If otherwise dis- posed of, so indicate)		
Common Stock	Dec. 8		90,000 *	(1)	900
\$1.20 Cum. Pfd. Stock	" 8	90,000 **		(1)	
do	" 9		1,400	(1)	48,600
do				Direct	None
<p>* Exchanged for an equal number of shares of \$1.20 Cumulative Preferred Stock pursuant to offer of exchange dated October 22, 1934.</p> <p>** Received in exchange for Common Stock.</p> <p>(1) Transactions and holdings of Lehn Brothers a partnership of which I am a member. I have previously waived all interests in a total of 90,000 of these shares.</p>					

JOSEPH A. THOMAS

REMARKS:

Sgt

*[Signature]*  
(Signature)

Agent in Fact

Date of report January 7, 1935

One copy of this report should be sent to the Securities and Exchange Commission. One copy should also be sent to each exchange on which any equity security of the issuer is listed unless the issuer has designated a single exchange to receive reports.

\* Indicate whether an officer (giving title of office), director, or direct or indirect beneficial owner of more than 10 percent of any class of any equity security (giving name of security), or any combination of them.

\*\* The term "equity security" means any stock or similar security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right. (Section 3 (a) (11) Securities Exchange Act.)

(SEE INSTRUCTIONS ON BACK)

<u>Trade Date</u>	<u>Shares Sold</u>	<u>Price</u>	<u>Proceeds</u>
12/9/54	1300	27-1/8	35,148.04
	100	27-1/4	2,716.19
1955			
1/5/55	22000	27----	591,348.12
1/13/55	2000	27-5/8	55,073.89
1/21/55	400	27-1/2	10,964.78
1/25/55	600	27-1/2	16,447.17
1/28/55	600	27-5/8	16,522.16
1/31/55	100	27-5/8	2,753.69
2/1/55	300	27-5/8	8,261.08
2/2/55	2000	27-5/8	55,073.89
	700	27-5/8	19,275.86
2/3/55	900	27-5/8	24,812.50
	1600	27-5/8	44,059.11
2/4/55	2400	27-5/8	66,088.67
2/9/55	1000	27-1/2	27,411.95
2/10/55	100	27-5/8	2,753.69
	900	27-1/2	24,670.75
2/11/55	700	27-5/8	19,275.86
	500	27-1/2	13,705.97
	100	27-5/8	2,753.69
2/14/55	500	27-1/2	13,705.97
	500	27-5/8	13,768.47
2/15/55	200	27-5/8	5,507.38
	700	27-1/2	19,188.36
2/16/55	1300	27-5/8	35,798.03
2/17/55	1000	27-1/2	27,411.95
2/18/55	200	27-1/2	5,482.38
	300	27-1/2	8,223.58
2/24/55	1000	27-1/2	27,411.95
3/2/55	400	27-5/8	11,014.77
	500	27-1/2	13,705.97
3/3/55	1600	27-5/8	44,059.11
3/4/55	300	27-3/4	8,298.58
3/7/55	200	27-5/8	5,507.38
	2000	27-3/4	55,323.89
3/8/55	1000	27-3/4	27,661.94
			<u>\$1,361,186.77</u>



(DO NOT USE THIS SPACE)

## FORM 4

## SECURITIES AND EXCHANGE COMMISSION

WASHINGTON 25, D. C.

IF THERE HAVE BEEN ANY CHANGES IN OWNERSHIP OF ANY EQUITY SECURITY OF THE COMPANY NAMED BELOW DURING THE LAST CALENDAR MONTH, THIS FORM SHOULD BE FILED BY OFFICERS AND DIRECTORS OF SUCH COMPANY IF IT HAS EQUITY SECURITIES LISTED AND REGISTERED, AND BY BENEFICIAL OWNERS OF MORE THAN 10 PERCENT OF ANY CLASS OF LISTED AND REGISTERED EQUITY SECURITIES OF SUCH COMPANY

Report for Calendar Month Ending January 31, 1939

**YING YUEN ASSOCIATED OIL COMPANY INCORPORATED**

(Name of company which issued security)

**JOSEPH A. THOMAS**

(Name of person whose change of ownership is reported) (Type or print)

**301 WILLIAM STREET, NEW YORK 4, N.Y.**

(Business address: street, city, State)

The relation of the undersigned to the issuer is that of

**DIRECTOR**

IDENTIFICATION OF SECURITY (Such as Class "A" Common Stock, 10 Preferred Stock, etc.)	The following changes (whether by purchase, sale, or change, gift, or otherwise) in the amounts of equity securities of the above issuer owned by the undersigned during the calendar month named above. (Report each transaction separately)		The undersigned owned directly or indirectly as beneficial owner, at the date of the calendar month named above, the following amounts of equity securities of the above issuer:		
	Date of Trans- action  1939	NUMBER OF SHARES OR UNITS ON FRACTIONAL ACCOUNT		Name or Address of Beneficial Owner of Shares or Units as Beneficial Owner (If different from the company, partnership, etc.)	
		BOUGHT (If otherwise ac- quired, so indicate)	SOLD (If otherwise dis- posed of, so indicate)	Number of Shares or Units on Fractional Account Owned at Close of Month Name Above	
Common Stock				(1)	300
\$1.20 Cum. Pfd. Stock	Jan. 9		22,000		
do	" 13		2,000		
do	" 21		400		
do	" 25		600		
do	" 28		600		
do	" 31		100		
				Direct	22,700 Indirect

(1) Transactions & holdings of Lehman Brothers a partnership of which I am a member. I have previously waived all interests in a total of 30,000 of these shares.

JOSEPH A. THOMAS



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SECURITIES & EXCH. COMM.

11/15/14

**WASHINGTON 25, D. C.**

**IS THERE HAVE BEEN ANY CHANGES IN OWNERSHIP OF ANY EQUITY SECURITY OF THE COMPANY NAMED BELOW DURING THE LAST CALENDAR MONTH, THIS FORM SHOULD BE FILED BY OFFICERS AND DIRECTORS OF SUCH COMPANY IF IT HAS EQUITY SECURITIES LISTED AND REGISTERED, AND BY BENEFICIAL OWNERS OF MORE THAN 10 PERCENT OF ANY CLASS OF LISTED AND REGISTERED EQUITY SECURITIES OF SUCH COMPANY**

October 30 1954

**Report for Calendar Month Ending** October 30, 1955

~~THIS PAGE ASSOCIATED WITH OTHER INFORMATION~~

206471 A. THIAS

(Name of person whose change of ownership is recorded) (Type or print)

~~DR. WILLIAM STONE, NEW YORK, N. Y.~~

The relation of the undersigned to the issuer is that of:

## NUMEROUS

IDENTIFICATION OF SECURITY (Such as "Class A" Common Stock, 20 Preferred Shares, etc.)	The following changes (whether by purchase, sale, ex- change, gift, or otherwise) in the amounts of equity securities of the above issuer owned by the undersigned occurred during the calendar month named above. (Report each transaction separately)		The undersigned owned directly or indirectly as beneficial owner, at the close of the calendar month named above, the following amounts of equity securities of the above issuer		
	DATE OF TRANS- ACTION	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT		NATURE OF OWNERSHIP (Whether direct or through hold- ing company, partnership, etc.)	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT OWNED AT CLOSE OF MONTH NAMED ABOVE
		BOUGHT (If otherwise ac- quired, so indicate)	SOLD (If otherwise dis- posed of, so indicate)		
	1934				
Common Stock	Oct. 8	20,000		(1)	
do	12	2,000		(1)	
do	13	900		(1)	
do	14	1,300		(1)	
do	15	100		(1)	
do	22	1,900		(1)	
do	25	1,300		(1)	
do	26	2,300		(1)	
do	27	1,700		(1)	
do	29	1,000		(1)	
				Direct	32,300 Shares

(1) Transactions and holdings of Lehman Brothers, a partnership of which I am a member. I have waived all interests in the purchase of the above shares, amounting to 32,300 shares.

REMARKS:

JOSEPH A. THOMAS

[illegible]

██████████ ██████████ ██████████

*[Signature]*

\* The term "equity security" means any stock or similar security; or any security convertible, with or without consideration, into such a security; or carrying any contract or right to subscribe to or purchase such a security; or any such contract or right. (Section 3 (a) (3) Securities Exchange Act.)

**SEE INSTRUCTIONS ON PAGE**



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## DIRECTOR

IDENTIFICATION OF SECURITY (Check as "New" "A" "Common Stock," "Preferred Stock," etc.)	The following change (whether by purchase, sale, change, gift, or otherwise) in the ownership of equity securities of the above issuer, owned by the undersigned, occurred during the calendar month named above. (Report each transaction separately)	The undersigned owned directly or indirectly or beneficial owner, at the date of the calendar month named above, the following amount of equity securities of the above issuer:	
	Date of Transaction	NUMBER OF SHARES OR UNITS ON PARTICULAR ACCOUNT	
		BOUGHT (If others as co-purchaser, so indicate)	BOLE (If otherwise disposed of, so indicate)
Common Stock	Nov. 1	1,100	
	3	1,000	
	4	1,200	
	5	1,200	
	8	1,200	
	9	1,200	
	10	1,000	
	11	300	
	12	300	
	13	4,000	
(1) Transactions and holdings of Lehman Brothers a partnership of which I am a member. I have valued all interests in the purchase of the above shares amounting to 14,000 shares.			
(2) I have valued all interests in a total of 30,000 of these shares.			
			30,000 Shares

REMARKS:

JOSEPH A. THOMAS

By

Agent in Fact

Date of report

December 7, 1934

One copy of this report should be sent to the Securities and Exchange Commission. One copy should also be sent to each exchange on which any equity security of the issuer is listed unless the issuer has designated a single exchange to receive reports.

<sup>1</sup> Indicate whether an officer (giving title of office), director, or direct or indirect beneficial owner of more than 10 percent of any class of any equity security (giving name of security), or any combination of these.

<sup>2</sup> The term "equity security" means any stock or similar security; or any security convertible, with or without consideration, into such a security; or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right. (Section 3 (a) (1) Securities Exchange Act.)

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11/10/55 *RL*

FORM 4

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON 25, D. C.

IF THERE HAVE BEEN ANY CHANGES IN OWNERSHIP OF ANY EQUITY SECURITY OF THE COMPANY NAMED BELOW DURING THE LAST CALENDAR MONTH, THIS FORM SHOULD BE FILED BY OFFICERS AND DIRECTORS OF SUCH COMPANY IF IT HAS EQUITY SECURITIES LISTED AND REGISTERED, AND BY BENEFICIAL OWNERS OF MORE THAN 10 PERCENT OF ANY CLASS OF LISTED AND REGISTERED EQUITY SECURITIES OF SUCH COMPANY

Report for Calendar Month Ending December 31, 1954

**TIDE WATER ASSOCIATED OIL COMPANY INCORPORATED**

(Name of company which issued security)

**JOSEPH A. THOMAS**

(Name of person whose change of ownership is reported (Type or name))

**ONE WILLIAM STREET, NEW YORK 4, NEW YORK**

(Business address: street, city, State)

The relation of the undersigned to the issuer is that of DIRECTOR

**DIRECTOR**

IDENTIFICATION OF SECURITY (Such as "Class A" Common Stock, 20 Preferred Stock, etc.)	The following changes (whether by purchase, sale, ex- change, gift, or otherwise) in the amount of equity ownership of the above issuer owned by the undersigned occurring during the calendar month named above. (Report each transaction separately)			The undersigned owned directly or indirectly as beneficial owner, at the date of the calendar month named above, the following amount of equity ownership of the above issuer	
	DATE OF TRANS- ACTION <b>1954</b>	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT		NATURE OF OWNERSHIP (Whether direct or through hold- ing company, partnership, etc.)	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT OWNED AT CLOSE OF MONTH NAMED ABOVE
		BOUGHT (If others are ac- quired, so indicate)	SOLD (If otherwise dis- posed of, so indicate)		
Common Stock	Dec. 8		30,000 *	(1)	300
\$1.20 Cum. Pref. Stock	" 8	30,000 **		(1)	
do	" 9		1,400	(1)	28,600
do				Direct	None
<p>* Exchanged for an equal number of shares of \$1.20 Cumulative Preferred Stock pursuant to offer of exchange dated October 22, 1954.</p> <p>** Received in exchange for Common Stock.</p> <p>(1) Transactions and holdings of Lakson Brothers a partnership of which I am a member. I have previously valued all interests in a total of 30,000 of these shares.</p>					
JOSEPH A. THOMAS					

(DO NOT USE THIS SPACE)

(Business address: street, city, county)

The relation of the undersigned to the issuer is that of <sup>1</sup>

## DIRECTOR

IDENTIFICATION OF SECURITY (Such as Class "A" Common Stock, 10 Preferred Stock, etc.)	The following changes (whether by purchase, sale, exchange, gift, or otherwise) in the amounts of equity security of the above issuer owned by the undersigned occurred during the calendar month named above (Report each transaction separately)		The undersigned owned directly or indirectly or beneficial owner, at the close of the calendar month named above, the following amounts of equity securities of the above issuer		
	Date or Time period	NUMBER OF SHARES OR OTHER OR FRACTIONAL AMOUNTS		Number of Shares or Other FRACTIONAL AMOUNTS (If owned indirectly, beneficially, etc.)	Number of Shares or Other FRACTIONAL AMOUNTS (If owned indirectly, beneficially, etc.)
		BOUGHT (If otherwise specified, so indicate)	SOLD (If otherwise specified, so indicate)		
Common Stock				(1)	300
\$1.20 Com. Pfd. Stock	Jan. 9		22,000	(2)	
do	" 13		2,000	(2)	
do	" 21		400	(2)	
do	" 23		600	(2)	
do	" 28		600	(2)	
do	" 31		100	(2)	
				Direct	22,900 None
(1) Transactions & Holdings of Lehman Brothers a partnership of which I am a member. I have previously waived all interests in a total of 90,000 of these shares.					

REMARKS:

JOSEPH A. THOMAS

By W. H. G. Jordan Agent in FactDate of report February 9, 1935

One copy of this report should be sent to the Securities and Exchange Commission. One copy should also be sent to each exchange on which any equity security of the issuer is listed unless the issuer has designated a single exchange to receive reports.

<sup>1</sup> Indicate whether an officer (giving title of office), director, or direct or indirect beneficial owner of more than 10 percent of any class of any equity security (giving name of security), or any combination of them.

\*The term "equity security" means any stock or similar security; or any security convertible, with or without consideration, into such a security; or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right. (Section 3 (a) (11) Securities Exchange Act.)

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FORM 4

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON 25, D. C.

IF THERE HAVE BEEN ANY CHANGES IN OWNERSHIP OF ANY EQUITY SECURITY OF THE COMPANY NAMED HEREIN DURING THE LAST CALENDAR MONTH, THIS FORM SHOULD BE FILED BY OFFICERS AND DIRECTORS OF SUCH COMPANY IF IT HAS EQUITY SECURITIES LISTED AND REGISTERED, AND BY BENEFICIAL OWNERS OF SUCH STOCK IS FURNISHING OF ANY CLASS OF LISTED AND REGISTERED EQUITY SECURITIES OF SUCH COMPANY.

Report for Calendar Month Ending January 31, 1934

THE COMPANY NAMED HEREIN IS A

INCORPORATED IN THE STATE OF

The relation of the undersigned to the issuer is that of:

IDENTIFICATION OF SECURITY (Name of Security, Class, and Series)	NAME OF SECURITY HOLDER		DATE OF ACQUISITION		DATE OF SALE	
	NAME	ADDRESS	DATE	QUANTITY	DATE	QUANTITY
Common Stock, No. 1	J. Edgar Hoover	Federal Bureau of Investigation Washington, D. C.	1/1/34	100	1/1/34	100

REMARKS:

JOHN L. WILSON



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# FORM 4 SECURITIES AND EXCHANGE COMMISSION

WASHINGTON 25, D. C.

## REPORT

IDENTIFICATION OF SECURITY (Such as "1000 A" (Common Stock, 10 Preferred Stock, etc.)	The following changes (whether by purchase, sale, ex- change, gift, or otherwise) in the amounts of equity securities of the above issuer owned by the undersigned covered during the calendar month named above. (Report each transaction separately)		The undersigned owned directly or indirectly as beneficial owner, at the close of the calendar month named above, the following amounts of equity securities of the above issuer				
	Date of Trans- action	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT		NAME OF OWNERS (Whether direct or through hold- ing company, partnership, etc.)	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT OWNED AT CLOSE OF MONTH NAMED ABOVE		
		BOUGHT (If otherwise ac- quired, so indicate)	SOLD (If otherwise dis- posed of, so indicate)				
G.L. & Co. P.M. Stock	Feb. 1		300	Direct	4,000		
	2		2,700				
	3		2,300				
	4		2,400				
	9		1,000				
	10		1,000				
	11		1,300				
	14		1,000				
	15		300				
	16		1,300				
	17		1,000				
	18		300				
	21		1,000				
	Common Stock					Direct	300
						Direct	

(1) Transactions and holdings of Latham Brothers a partnership of which I  
am a partner. I have previously valued all interests in a total of  
\$5,000 of these shares.

REMARKS:

JOHN A. LAMM

Signed *[Signature]* Agent in Fact

Date of report March 7, 1960

One copy of this report should be sent to the Securities and Exchange Commission. One copy should also be sent to each exchange on which any equity security of the issuer is listed unless the issuer has designated a single exchange to receive reports.

\* Indicates whether an officer (giving title of office), director, or direct or indirect beneficial owner of more than 10 percent of any class of any equity security (giving name of security), or any combination of them.

\* The term "equity security" means any stock or similar security; or any security convertible, with or without consideration, into such a security; or carrying any warrant or right to subscribe to or purchase such a security; or any cash warrant or right. (Section 3 (a) (11) Securities Exchange Act.)

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4-6-55 JH-

FORM 4

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON 25, D. C.

IF THERE HAVE BEEN ANY CHANGES IN OWNERSHIP OF ANY EQUITY SECURITY OF THE COMPANY NAMED BELOW DURING THE LAST CALENDAR MONTH, THIS FORM SHOULD BE FILED BY OFFICERS AND DIRECTORS OF SUCH COMPANY IF IT HAS EQUITY SECURITIES LISTED AND REGISTERED, AND BY BENEFICIAL OWNERS OF MORE THAN 10 PERCENT OF ANY CLASS OF LISTED AND REGISTERED EQUITY SECURITIES OF SUCH COMPANY

Report for Calendar Month Ending

March 31, 1955

TIDE WATER ASSOCIATED OIL COMPANY INCORPORATED

(Name of company which issued security)

JOSEPH A. THOMAS

(Name of person whose change of ownership is reported) (Type or print)

ONE WILLIAM ST. EBY, NEW YORK 4, NEW YORK

(Business address: street, city, State)

The relation of the undersigned to the issuer is that of

DIRECTOR

IDENTIFICATION OF SECURITY (Such as Class "A" Common Stock, 8% Preferred Stock, etc.)	DATE OF TRANSACTION 1955	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT		NATURE OF OWNERSHIP (Whether direct or through holding company, partnership, etc.)	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT OWNED AT CLOSE OF MONTH NAME ABOVE
		BOUGHT (If otherwise acquired, so indicate)	SOLD (If otherwise disposed of, so indicate)		
\$1.20 Com. Pfd. Stock	March 2		900	(1)	
do	" 3		1,600	(1)	
do	" 4		300	(1)	
do	" 7		2,200	(1)	
do	" 8		1,000	(1)	
Common Stock				Direct	None
do				(1)	300
do				Direct	None

(1) Transactions and holdings of Leman Brothers a partnership of which I am a partner. I have previously waived all interests in a total of 50,000 of these shares.

REMARKS:

JOSEPH A. THOMAS

RECEIVED BY

FORM 4

## TIDE WATER ASSOCIATED OIL COMPANY INCORPORATED

(Name of company which issued security)

JOSEPH A. THOMAS

(Name of person whose change of ownership is reported) (Type or print)

ONE WILLIAM ST. EBY, NEW YORK 4, NEW YORK

(Business address, street, city, State)

The relation of the undersigned to the issuer is that of

## DIRECTOR

IDENTIFICATION OF SECURITY (Such as Class "A" Common Stock, 10 Preferred Stock, etc.)	DATE OF TRANS- ACTION  1955	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT		NATURE OF OWNERSHIP (Whether direct or through hold- ing company, partnership, etc.)	NUMBER OF SHARES OR UNITS OR PRINCIPAL AMOUNT OWNED AT CLOSE OF MONTH NAMED ABOVE
		BOUGHT (If otherwise ac- quired, so indicate)	SOLD (If otherwise dis- posed of, so indicate)		
\$1.20 Cum. Pfd. Stock	March 2		900	(1)	
do	" 3		1,600	(1)	
do	" 4		300	(1)	
do	" 7		2,200	(1)	
do	" 8		1,000	(1)	None
Common Stock				Direct	None
do				(1)	300
do				Direct	None

(1) Transactions and holdings of Lehman Brothers a partnership of which I am a partner. I have previously waived all interests in a total of 50,000 of these shares.

REMARKS:

JOSEPH A. THOMAS

By

Agent in Fact

(Signature)

Date of report April 7, 1955

One copy of this report should be sent to the Securities and Exchange Commission. One copy should also be sent to each exchange on which any equity security of the issuer is listed unless the issuer has designated a single exchange to receive reports.

<sup>1</sup> Indicate whether an officer (giving title of office), director, or direct or indirect beneficial owner of more than 10 percent of any class of any equity security (giving name of security), or any combination of these.

\* The term "equity security" means any stock or similar security; or any security convertible, with or without consideration, into such a security; or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right. (Section 3 (a) (11) Securities Exchange Act.)

(SEE INSTRUCTIONS ON BACK)

# TIDE WATER ASSOCIATED OIL COMPANY

17 BATTERY PLACE

NEW YORK 4, N. Y.

October 22, 1954

*To the Stockholders of*

TIDE WATER ASSOCIATED OIL COMPANY:

You were advised on April 29th of this year that your Corporation has undertaken and is carrying on a comprehensive coordinated program of expansion and modernization calling for large expenditures and designed to increase its reserves of crude oil and natural gas, to add to and modernize its refining facilities and to improve its marketing position. As stated at that time the Board of Directors concluded it to be advisable to finance the expansion and modernization program largely out of current cash earnings, with the result that the amount of cash earnings available for dividends will be greatly reduced. Accordingly, no cash dividends were declared for the second and third quarters of this year. A 5% stock dividend was distributed on June 23, 1954.

While most of the stockholders appear to be content to forego cash dividends in return for the possibility of greater earnings and values which should result from the capital expenditures necessitated by the program of expansion and modernization, some stockholders have expressed their desire to receive cash dividends in an amount at least as large as those previously received. The management of the Corporation has studied the matter and has evolved a Plan of Recapitalization whereby all the stockholders, other than Mission Development Company, Mission Corporation, and Pacific Western Oil Corporation, which corporations together own approximately 53% of the outstanding Common Stock, will be given the opportunity to exchange their Common Stock for a Cumulative Preferred Stock (hereinafter called "Preferred Stock") which will carry dividends at the rate of \$1.20 annually.

In order to make possible the Plan, Mission Development Company, Mission Corporation, and Pacific Western Oil Corporation have agreed to waive and forego any right to exchange the Common Stock held by them for such Preferred Stock.

This Plan will permit those stockholders who so desire, to receive cash dividends at a rate slightly higher than the highest dividends paid on the Common Stock in any year, by exchanging their Common Stock for such Preferred Stock, and at the same time will permit those stockholders who place a greater value on future growth possibilities to retain their Common Stock with full knowledge that it is likely that no cash dividends will be paid thereon for a number of years or if paid, that such dividends will be small in comparison with dividends paid on the Common Stock in prior years. The Board of Directors has concluded this to be preferable, rather than to pay greatly reduced dividends to all stockholders. The Corporation may, of course, distribute further stock dividends on the Common Stock in the future. Those stockholders who desire both cash dividends and the opportunity to share in future growth may, of course, exchange only a portion of the stock held by them and retain a portion of their Common Stock.

In order to put the Plan into effect it is necessary to amend the Certificate of Incorporation to provide for the creation of the Preferred Stock and to obtain the consent of the holders of a

majority of the Common Stock outstanding to the issuance of the Preferred Stock pursuant to the Plan. A meeting has been called for these purposes and in order to permit the stockholders to vote on the proposed Plan of Recapitalization.

There are enclosed herewith the following documents:

1. Notice of Special Meeting of Stockholders to be held on November 15, 1954;
2. Proxy Statement, having attached thereto the Plan of Recapitalization and the proposed amended Article ELEVENTH of the Certificate of Incorporation. The proposed amended Article FOURTH of the Certificate of Incorporation is annexed to the Plan of Recapitalization;
3. Form of Proxy for signature and return, together with postage prepaid return envelope;
4. Offer of Exchange, and
5. Letter of Transmittal for those stockholders who wish to take advantage of the Offer of Exchange, together with an envelope addressed to The Chase National Bank of the City of New York, Exchange Agent, 11 Broad Street, New York 15, N. Y.

You are requested to read all the documents carefully before taking any action.

2  
By order of the Board of Directors.

DAVID T. STAPLES,  
• President.



## **TIDE WATER ASSOCIATED OIL COMPANY**

**17 BATTERY PLACE  
NEW YORK 4, N. Y.**

### **OFFER OF EXCHANGE**

**Dated October 22, 1954**

*To the Stockholders of*

**TIDE WATER ASSOCIATED OIL COMPANY:**

This Offer of Exchange is submitted together with the Notice of Stockholders Meeting and Proxy Statement. The Plan of Recapitalization dated October 7, 1954 is attached to the Proxy Statement. You are requested to read the Proxy Statement and the Plan of Recapitalization attached thereto carefully before taking any action with respect to this Offer of Exchange.

Pursuant to the Plan of Recapitalization above referred to, Tide Water Associated Oil Company (hereinafter called the "Corporation"), hereby offers to issue to such of the holders of Common Stock who so elect, other than Mission Development Company, Mission Corporation and Pacific Western Oil Corporation shares of \$1.20 Cumulative Preferred Stock, \$25 par value, (hereinafter sometimes referred to as "Preferred Stock") of the Corporation, in exchange for all shares of Common Stock of the Corporation surrendered for cancellation in accordance with this Offer of Exchange, in the ratio of one share of Preferred Stock for each share of Common Stock so surrendered, subject, however, to the formal approval of the Plan of Recapitalization and the proposed amendment to Article Fourth of the Certificate of Incorporation by the holders of a majority of the outstanding Common Stock at the meeting of stockholders called to be held on November 15, 1954 as set forth in the aforesaid notice of meeting accompanying this Offer of Exchange, or at any adjournment or adjournments thereof and subject to such Amendment's becoming effective.

#### **DESCRIPTION OF PREFERRED STOCK AND INFORMATION CONCERNING THE BUSINESS, PROPERTY AND EARNINGS OF THE CORPORATION.**

The exact nature of the Preferred Stock and the designations, powers, preferences and special rights and the qualifications, limitations and restrictions thereof are set forth in the proposed amended Article Fourth of the Certificate of Incorporation which is annexed to the Plan of Recapitalization attached to the Proxy Statement accompanying this Offer of Exchange. In addition, there is a summary thereof in the Proxy Statement.

The Proxy Statement contains in addition, information essential to assist you in determining whether to retain your Common Stock or to exchange it in whole or in part for Preferred Stock. This information includes, among other things, data concerning the business, property and earnings of the Corporation, certain financial statements and the effect which the issuance of the Preferred Stock will have upon the Common Stock.

#### **DETAILS OF THE EXCHANGE OFFER**

The exchange offer is open to all holders of the Corporation's Common Stock, other than Mission Development Company, Mission Corporation and Pacific Western Oil Corporation, from the date of this exchange offer until 3:30 p.m. Eastern Standard Time, December 8, 1954 (such period being hereinafter called the "Exchange Period"). Any holder of the Corporation's Common Stock, other than Mission Development Company, Mission Corporation and Pacific Western Oil Corporation, may accept this exchange offer and deposit for exchange all or any number of the shares of Common Stock held by him. Any such stockholder may revoke his acceptance of this exchange offer and direct return of the deposited shares by giving notice thereof which shall be received by the Exchange

Agent at any time prior to 3:30 p.m. Eastern Standard Time, December 8, 1954. There may be no revocation thereafter.

Should the holders of a majority of outstanding Common Stock not give their formal approval to the Plan of Recapitalization and the proposed amendments to the Certificate of Incorporation at the meeting called to be held on November 15, 1954, this exchange offer shall become void and of no effect and the Corporation will in such event instruct the Exchange Agent to return to each common stockholder any shares of Common Stock deposited with the Exchange Agent by such stockholder.

Certificates for Preferred Stock, either in permanent or temporary form, will be delivered in exchange for the deposited shares of Common Stock, either against counter receipt or by mailing by registered mail as soon as practicable after the close of the Exchange Period. No Preferred Stock will be delivered prior to the close of the Exchange Period.

All shares of Common Stock which are exchanged will be cancelled and retired by the Corporation.

#### **METHOD OF EFFECTING EXCHANGES**

The Chase National Bank of the City of New York, 11 Broad Street, New York 15, N. Y., has been appointed Exchange Agent for this transaction. Common stockholders desiring to effect the exchange under this exchange offer should execute the accompanying Letter of Transmittal and forward it to the Exchange Agent, together with the stock certificates representing the shares to be exchanged. An envelope addressed to the Exchange Agent is enclosed for the convenience of stockholders desiring to effect such exchange. Letters of Transmittal and stock certificates properly endorsed or accompanied by an appropriate instrument described in the Instructions appearing on the back of the Letter of Transmittal, must be received by the Exchange Agent not later than 3:30 p. m. Eastern Standard Time on December 8, 1954.

#### **FEDERAL INCOME TAX RESULTS TO COMMON STOCKHOLDERS**

The Corporation is advised by counsel that, pending issuance of Regulations under the Internal Revenue Code of 1954, it may not be possible to obtain from the Commissioner of Internal Revenue a specific ruling on the transaction, but that in the opinion of such counsel no gain or loss will be recognized to present holders of Common Stock for Federal Income Tax purposes under the Internal Revenue Code of 1954 by reason of the receipt of Preferred Stock in exchange for their Common Stock pursuant to the Plan of Recapitalization under this exchange offer.

#### **PROPOSED LISTING ON THE NEW YORK STOCK EXCHANGE**

Application is being made for the listing of the Preferred Stock on the New York Stock Exchange. The Corporation is advised that whether such Preferred Stock will be accepted for listing will depend upon the number of stockholders who exchange their Common Stock for Preferred Stock. Application is also being made to the New York Stock Exchange for the admission to trading on the New York Stock Exchange of the Preferred Stock on a when-issued basis. The Corporation is advised that if the Preferred Stock is so admitted to trading on a when-issued basis, such trading will not commence until after the approval of the Plan of Recapitalization and the proposed amendments to the Certificate of Incorporation by the stockholders at the Stockholders' Meeting called to be held November 15, 1954.

#### **ADDITIONAL COPIES OF EXCHANGE OFFER**

Additional copies of the Offer of Exchange and the Notice of Stockholders Meeting and Proxy Statement may be secured in reasonable numbers from The Chase National Bank of the City of New York, 11 Broad Street, New York 15, N. Y., the Corporation's office at 17 Battery Place, New York 4, N. Y. and the Corporation's office at 79 New Montgomery Street, San Francisco 20, California.

By order of the Board of Directors.

DAVID T. STAPLES,  
President.



**TIDE WATER ASSOCIATED OIL COMPANY**

**17 BATTERY PLACE  
NEW YORK 4, N. Y.**

**NOTICE OF MEETING AND PROXY STATEMENT**

**Notice of Special Meeting of Stockholders**

**November 15, 1954**

*To the Stockholders of*

**TIDE WATER ASSOCIATED OIL COMPANY:**

PLEASE TAKE NOTICE that a Special Meeting of the stockholders of Tide Water Associated Oil Company, a Delaware corporation, hereinafter called the "Corporation", has been duly called by the Board of Directors to be held at the Hotel Roosevelt, Madison Avenue and 45th Street, New York, N. Y., on Monday, November 15, 1954, at 10:00 o'clock in the forenoon Eastern Standard Time, for the following purposes:

(1) To consider and act on a proposed amendment to Article FOURTH of the Certificate of Incorporation of the Corporation, which amendment has heretofore been declared advisable by the Board of Directors of the Corporation, to create and authorize the issuance of 6,300,000 shares of \$1.20 Cumulative Preferred Stock, \$25 par value each (hereinafter called "Preferred Stock"), in lieu of the presently authorized preferred stock without par value now provided for therein and to set forth the designation and the powers, preferences and special rights and the qualifications, limitations and restrictions thereof. The form of proposed amended Article FOURTH is set forth in Exhibit A to the Plan of Recapitalization (Exhibit 1, to the Proxy Statement attached hereto).

(2) To consider and act on a proposed Amendment to Article ELEVENTH of the Certificate of Incorporation of the Corporation, which Amendment has heretofore been declared advisable by the Board of Directors of the Corporation, to conform said Article ELEVENTH to the proposed Amendment to Article FOURTH of said Certificate of Incorporation insofar as it requires the consent of the holders of a majority of the outstanding Common Stock of the Corporation entitled to vote for the issuance of any shares of Preferred Stock or, on or after November 15, 1954, of any shares of Common Stock. The form of said amended Article ELEVENTH is set forth in Exhibit 2 to the Proxy Statement attached hereto.

(3) To consider and act on a proposed Plan of Recapitalization set forth in Exhibit 1 to the Proxy Statement attached hereto, which provides, among other things, for the creation of 6,300,000 shares of Preferred Stock, and for the making of an offer to the holders of the outstanding Common Stock of the Corporation, other than Mission Development Company, Mission Corporation and Pacific Western Oil Corporation, to exchange all or any part of the Common Stock held by such stockholders for shares of Preferred Stock on a share for share basis.

(4) To consider and act on the authorization and approval of, and consent to the issuance of the Preferred Stock pursuant to the Plan of Recapitalization in accordance with said amended Article ELEVENTH of the Certificate of Incorporation.

(5) To transact such other business as may properly come before the meeting or any adjournment or adjournments thereof.

Enclosed is a form of proxy prepared and sent to you at the direction of the Board of Directors of the Corporation.

The transfer books of the Corporation will not be closed, but in lieu thereof the Board of Directors has fixed the close of business on October 20, 1954, as the record date for the determination of stockholders entitled to notice of and to vote at the meeting and at any adjournment or adjournments thereof.

Respectfully submitted,

Dated: October 22, 1954

**BY ORDER OF THE BOARD OF DIRECTORS**

**WILLIAM J. BURKER  
Secretary**

## **TIDE WATER ASSOCIATED OIL COMPANY**

### **Proxy Statement**

This statement is furnished in connection with the solicitation of proxies to be used at a special meeting of the stockholders of Tide Water Associated Oil Company, a Delaware corporation (hereinafter sometimes called the "Corporation") to be held on November 15, 1954.

Proxies in the form enclosed herewith are solicited by the Management at the direction of the Board of Directors of the Corporation and the cost of solicitation is to be borne by the Corporation.

Any stockholder giving a proxy in such form has the power to revoke it at any time prior to the voting thereof. Unless so revoked the shares represented thereby will be voted at said special meeting, and at any and all adjournments thereof and, if any directions are indicated thereon by the stockholder, will be voted in accordance with such directions, if the proxy is returned properly executed and is received in time for voting.

The Corporation had outstanding at the close of business October 20, 1954, the record date for the determination of stockholders entitled to vote at the meeting, 13,433,299 shares of \$10 par value Common Stock, each of which is entitled to one vote.

### **DESCRIPTION OF MATTERS TO BE ACTED ON**

#### **Plan of Recapitalization**

The Board of Directors is submitting to the stockholders for their consideration and to be acted on a proposed Plan of Recapitalization (Exhibit 1 hereto), which provides in substance as follows:

(1) For the creation of 6,300,000 shares of \$1.20 Cumulative Preferred Stock, \$25 par value each (hereinafter called "Preferred Stock"), in lieu of and in substitution for the 873,779 shares of preferred stock without par value (hereinafter called "Old Preferred"), presently authorized, and none of which is outstanding. The designations, preferences and special rights, and the qualifications, limitations and restrictions of such Preferred Stock are set forth in the proposed Amendment to Article Fourth of the Certificate of Incorporation, Exhibit A to the Plan of Recapitalization and are summarized hereinafter under the heading "Preferred Stock."

(2) For the making of an offer to the holders of the outstanding Common Stock, \$10 par value of the Corporation (hereinafter called "Common Stock"), of the privilege until 3:30 P.M. Eastern Standard Time on December 8, 1954, of surrendering all or any part of the shares of such Common Stock owned by them for cancellation in exchange for the issuance to them of shares of such Preferred Stock in the ratio of one share of such Preferred Stock for each share of Common Stock surrendered and for the cancellation and retirement after the termination of the period of exchange of each share of such Common Stock so surrendered. Such offer will not be available to Mission Development Company, Mission Corporation, or Pacific Western Oil Corporation which, together own and hold approximately 53% of the presently issued and outstanding Common Stock of the Corporation. Any stockholder may revoke his acceptance of such offer and direct the return of his shares surrendered by giving notice thereof, which shall be received prior to 3:30 P.M. E. S. T. December 8, 1954. No revocation will be permitted thereafter.

(3) For the transfer to the Preferred Stock Capital Account to be set up on the books of the Corporation, in respect of each share of Preferred Stock issued in exchange for Common Stock, of the sum of \$25, by transferring to such Preferred Stock Capital Account from Common Stock Capital Account in respect of each share of Common Stock received by the Corporation for exchange and surrendered for cancellation and retirement, the sum of \$10, presently set up on the books as the capital in respect of each share of such Common Stock, and by transferring from the Retained Profits Reinvested Account to the Preferred Stock Capital Account in respect of each such share of Preferred Stock so issued the sum of \$15, so that the Preferred Stock Capital Account shall equal \$25 for each share of Preferred Stock so issued.

The Plan of Recapitalization summarized above is set forth in full in Exhibit 1 hereto, to which reference is made for full and complete statements of the provisions of such Plan of Recapitalization.

The vote of the holders of a majority of Common Stock issued and outstanding on the record date is deemed necessary for approval of the Plan of Recapitalization. The management of the Corporation has not set, and does not intend to set, any minimum percentage of favorable votes of shares of Common Stock held by persons other than Mission Development Company, Mission Corporation and Pacific Western Oil Corporation as a prerequisite to proceeding with the Plan of Recapitalization.

The Offer of Exchange is being mailed herewith to each holder of Common Stock of the Corporation of record at the close of business October 20, 1954. Such offer is open to all holders of Common Stock of the Corporation, except Mission Development Company, Mission Corporation and Pacific Western Oil Corporation, until 3:30 P. M. Eastern Standard Time on December 8, 1954. Reference is made to the Offer of Exchange for the full terms and conditions of such offer.

#### **The Proposed Amendments to the Certificate of Incorporation**

The proposed amendment to Article Fourth of the Certificate of Incorporation (Exhibit A to the Plan of Recapitalization annexed hereto), "provides for the creation of 6,300,000 shares of Preferred Stock, the designations, preferences and special rights and the qualifications, limitations and restrictions of which are hereinafter summarized under the heading "Preferred Stock".

The proposed amendment to Article Eleventh of the Certificate of Incorporation (Exhibit 2 hereto), sets forth technical changes to said Article necessitated by the proposed amendment to Article Fourth. The portion of Article Eleventh changed by such amendment provides that the Corporation shall not, without the consent of the holders of a majority of the Common Stock, given in writing without a meeting or by resolution adopted at a meeting duly called for that purpose, issue any shares of Preferred Stock or, on or after November 15, 1954, any shares of Common Stock of the Corporation.

The vote of the holders of a majority of the shares of Common Stock issued and outstanding on the record date is required for approval of each of the proposed amendments.

#### **Consent to the Issuance of Preferred Stock**

The effect of the proposed Amendment to Article Eleventh of the Certificate of Incorporation, if adopted, would be to prohibit, without consent of the holders of a majority of the Common Stock given in writing without a meeting or by resolution adopted at a meeting duly called for that purpose, the issuance, on and after November 15, 1954, of further shares of Common Stock, and the issuance of any shares of Preferred Stock pursuant to the Plan of Recapitalization and Offer of Exchange and the issuance of shares of Preferred Stock in excess of the shares issued in exchange for Common Stock pursuant to the Offer of Exchange. If said amendment to Article Eleventh is adopted, there will be submitted to the meeting for adoption by the holders of a majority of the Common Stock issued and outstanding on the record date, a resolution authorizing, approving and consenting to the issuance of Preferred Stock pursuant to the Plan of Recapitalization in accordance with said amendment to Article Eleventh of the Certificate of Incorporation.

The management of the Corporation is advised that it is the present intention of Mission Development Company, Mission Corporation and Pacific Western Oil Corporation to vote in favor of each of the foregoing matters to be acted on at the meeting.

#### **PREFERRED STOCK**

**General:** The Preferred Stock is to be created by the proposed amendment to the Certificate of Incorporation. The statements herein concerning such Preferred Stock are an outline, do not purport to be complete, and are qualified in their entirety by reference to the proposed amendment to Article Fourth of the Certificate of Incorporation, Exhibit A to the Plan of Recapitalization (Exhibit 1 hereto).

**Dividends:** The Preferred Stock is entitled to quarterly cumulative dividends, when and as declared, at the rate of \$1.20 per annum (and no more), payable in cash on the 10th day of January, April, July and October in each year, commencing January 10, 1955, out of funds legally available

for the payment of dividends in preference to any dividends or distributions on junior stock. No interest is payable on dividends in arrears.

**Redemption:** The Preferred Stock may be redeemed at the option of the Corporation at any time in whole or in part, upon at least thirty days' notice at the following redemption prices per share (the "optional redemption price"), plus accrued dividends thereon to the date fixed for redemption:

If redeemed on or before January 10, 1956, \$30.00; if redeemed after January 10, 1956 but on or before January 10, 1957, \$29.00; if redeemed after January 10, 1957 but on or before January 10, 1958, \$28.00; if redeemed after January 10, 1958 but on or before January 10, 1959, \$27.00; if redeemed after January 10, 1959 but on or before January 10, 1960, \$26.00; if redeemed after January 10, 1960, \$25.00.

In case of redemption of less than all of the outstanding Preferred Stock, such redemption shall be made, pro rata or the shares to be redeemed shall be chosen by lot, in such manner as the Board of Directors shall determine.

**Sinking Fund:** The Preferred Stock will be entitled to the benefits of a sinking fund subject to the restrictions referred to below under "Voting Rights and Restrictions on Certain Corporate Action". For so long as any shares of Preferred Stock shall be outstanding, on or before June 10 and December 10 in each year, commencing with June 10, 1960, the Corporation is to set apart, as a sinking fund, an amount in cash sufficient to redeem on the July 10 or January 10, whichever shall first occur, next ensuing, at the sinking fund redemption price of \$25 per share, plus accrued dividends thereon to the date fixed for redemption, such number of whole shares of Preferred Stock, as shall equal, to the nearest fraction,  $1\frac{1}{4}\%$  of the greatest number of shares of Preferred Stock theretofore at any time outstanding. On each such July 10 and January 10, the Corporation is to redeem such shares of Preferred Stock at the sinking fund redemption price in the manner as prescribed for optional redemption.

The Corporation may satisfy its sinking fund obligation in whole or in part by crediting against such obligation at the sinking fund redemption price, shares of Preferred Stock purchased prior to the date on which sinking fund payments are required to be set aside.

**Liquidation Rights:** Subject to the restrictions referred to below under "Voting Rights and Restrictions on Certain Corporate Action", in the event of any liquidation, dissolution or winding up of the Corporation, the holders of Preferred Stock are entitled to receive in cash, before any distribution of the Corporation's assets to the holders of any class of stock junior to the Preferred Stock, an amount equal to the optional redemption price of such Preferred Stock at the time of such liquidation, dissolution or winding up, plus accrued dividends to the date of payment and no more. The consolidation or merger of the Corporation with or into another corporation, or the sale, lease or conveyance of all or substantially all of the assets of the Corporation shall not be deemed a liquidation, dissolution or winding up of the Corporation.

**Voting Rights and Restrictions on Certain Corporate Action:** Holders of Preferred Stock do not vote except as required by law, and as follows:

1. If and when dividends on the Preferred Stock are in arrears in an aggregate amount at least equal to six quarterly dividends, the holders of such Preferred Stock will have the right, until all arrears of dividends, and the dividends for the current quarterly period shall have been paid or declared and provided for, to vote as a class to elect two members of the Board of Directors, provided that the respective term of office of each such director shall *ipso facto* cease and terminate when dividends on the Preferred Stock shall cease to be in arrears, and the dividends for the then current quarterly period shall have been paid or declared and provided for, and the vacancies created by such termination of office of each such director may be filled by a majority of the remaining directors in accordance with the By-Laws of the Corporation.

2. Without affirmative vote or written consent of at least two-thirds of the outstanding Preferred Stock, voting as a class, the Corporation may not:

- (a) Authorize any additional class of stock ranking prior to the Preferred Stock; or

(b) Subject to the provisions summarized in paragraph 3 below, amend, alter or repeal any provision of the Certificate of Incorporation, as amended, or any other certificate filed pursuant to law which would adversely affect any special right or preference of the outstanding shares of Preferred Stock; or

(c) Authorize the voluntary dissolution, liquidation or winding up of the Corporation unless the holders of the Preferred Stock will receive on such dissolution, liquidation or winding up the cash equivalent of the optional redemption price at such time, plus accrued dividends thereon; or

(d) Subject to the provisions summarized in paragraph 3 below, merge or consolidate the Corporation with or into any other corporation, unless the surviving corporation will have no class of stock, ranking prior to the Preferred Stock or the stock, if any, issued to the holders of such Preferred Stock in connection with such merger or consolidation; or

(e) Give any guaranty, or similar obligation for the payment of any amounts by way of dividends on, or for the redemption or retirement of, the stock of any other corporation.

3. The vote and consent of the holders of the Preferred Stock shall not be required for:

(a) The merger or consolidation of the Corporation with or into, or the sale of all or substantially all of the assets of the Corporation to any other corporation, and the authorization and issuance in connection therewith by the corporation resulting from or surviving such merger or consolidation, or to which such assets are so sold, of shares of stock ranking on a parity with the Preferred Stock (or the stock, if any, issued to holders of Preferred Stock in lieu thereof in connection with such merger or consolidation or sale of assets), in lieu of or in exchange for stock of any corporation which is a party to such merger or consolidation, or which shall purchase such assets, or in exchange for property or assets, provided that the Board of Directors of the Corporation shall determine that the value per share of such stock of such corporation, or in the case of property or assets, the value thereof, shall be at least equal to the par value, if any, of the stock so issued in lieu thereof or in exchange therefor; or

(b) The authorization of additional shares of Preferred Stock ranking on a parity with the Preferred Stock and the issuance thereof for cash, or for property or assets, provided that the Board of Directors of the Corporation shall determine the value of such property or assets to be at least equal to the par value, if any, of the stock issued in exchange therefor; or

(c) The amendment of the Certificate of Incorporation so as to change the dividend rates, the payment dates, the redemption or liquidation prices per share or the sinking fund provisions with respect to shares of Preferred Stock which are authorized but unissued.

**Miscellaneous:** Holders of fully paid shares of Preferred Stock are not liable for further calls or assessments by the Corporation or otherwise. The Preferred Stock has no preemptive rights. Shares of Preferred Stock which have been redeemed or acquired by the Corporation, and credited against the sinking fund requirements, or retired pursuant to the provisions of the General Corporation Law of the State of Delaware may not be reissued or resold. Shares of Preferred Stock may be repurchased by the Corporation irrespective of the existence of arrears of dividends on such stock. So long as any of the Preferred Stock shall be outstanding, no dividends except dividends or distributions payable in shares junior to such Preferred Stock, shall be declared or paid on any junior stock, nor shall shares of such junior stock be purchased or redeemed by the Corporation, or sinking fund requirements be satisfied in respect of such junior stock, except from earned surplus accumulated after December 31, 1953, and unless (a) all dividends on the Preferred Stock are current and not in arrears, and (b) all sinking fund requirements in respect of the Preferred Stock are currently satisfied.

The consent of the holders of a majority of the Common Stock outstanding and entitled to vote, given in writing without a meeting or by resolution at a meeting duly called for that purpose, is



required for the issuance of any shares of Preferred Stock remaining authorized but unissued after the issuance of shares of Preferred Stock in exchange for shares of Common Stock pursuant to the Offer of Exchange, and, on or after November 15, 1954, for the issuance of any shares of Common Stock. Subject to such consent the Board of Directors may issue any authorized but unissued shares of Preferred Stock or any authorized but unissued shares of Common Stock in accordance with the laws of the State of Delaware.

**Common Stock:** Subject to the rights of the Preferred Stock, the Common Stock is entitled to dividends as and when declared by the Directors, is entitled upon liquidation to receive the net assets of the Corporation, and is vested with all voting rights, each share being entitled to one vote. The Common Stock has no preemptive, subscription, or conversion rights, and holders of fully paid shares thereof are not liable to calls or assessments by the Corporation.

### **THE REASONS FOR THE OFFER OF EXCHANGE**

The Corporation has undertaken and is carrying on a comprehensive coordinated program of expansion and modernization calling for large expenditures and designed to increase its reserves of crude oil and natural gas, to add to and modernize its refining facilities and to improve its marketing position. On April 29, 1954, the stockholders were so advised and were also informed that the Board of Directors concluded it to be advisable to finance the expansion and modernization program largely out of current earnings, with the result that the amount of cash available for dividends will be greatly reduced. Accordingly, no cash dividends were declared for the second and third quarters of this year. A 5% stock dividend was distributed on June 23, 1954.

While most of the stockholders appear to be content to forego cash dividends in return for the possibility of greater earnings and values which should result from the capital expenditures necessitated by the program of expansion and modernization, some stockholders have expressed their desire to receive cash dividends in an amount no less than previously received. After considerable study of the matter the management of the Corporation evolved the Plan of Recapitalization whereby such of the stockholders who so desire, other than Mission Development Company, Mission Corporation and Pacific Western Oil Corporation which companies together own approximately 53% of the outstanding Common Stock, will be given the opportunity to exchange all or part of their Common Stock for a cumulative preferred stock which will carry a dividend at the rate of \$1.20 annually.

Execution of the Plan of Recapitalization will permit those stockholders, who so desire, to receive cash dividends at a rate slightly higher than the highest dividends paid on the Common Stock in any year by exchanging their Common Stock for such Preferred Stock, and at the same time will permit those stockholders who place a greater value on future growth possibilities to retain their Common Stock with full knowledge that it is likely that no cash dividends will be paid thereon for a number of years or, if paid, that such dividends likely will be small in comparison with dividends paid in prior years. The Board of Directors has concluded this to be preferable to paying greatly reduced dividends to all stockholders. Those stockholders who desire both cash dividends and the opportunity to share in future growth may, of course, exchange only a portion of the stock held by them and retain a portion of their Common Stock.

### **EFFECT OF THE PROPOSED EXCHANGE ON THE COMMON STOCK**

In the event that the proposed amendment to the Certificate of Incorporation is approved and shares of Common Stock are exchanged for shares of Preferred Stock, the rights of the holders of Common Stock will be diminished by the preferences, special rights and powers summarized above, granted to the Preferred Stock and except as so diminished, the rights of Common Stockholders who retain their stock will not be adversely affected. The possibility of the Common Stock receiving dividends will be reduced to the extent earnings are required for cumulative dividends, and the sinking fund and redemption requirements. The cash requirements of the expansion and modernization program limit the ability to pay cash dividends on the Common Stock for a number

of years. In addition, to the extent that shares of Common Stock are exchanged, the Retained Profits Reinvested Account presently available for dividends on the Common Stock will be reduced. To the extent that the underlying asset value of the Common Stock may now, or hereafter, be in excess of \$25 per share, and to the extent of the exchange effected, the proportionate equity of the Common Stockholders in the net assets and in the net earnings exceeding Preferred Stock dividend requirements of the Corporation and in the possible future enhancement thereof, will be increased. In accordance with oil industry practice, the balance sheets of the Corporation do not reflect fully the current value of oil and gas reserves of the Corporation. Such unreflected values, which are deemed substantial, after the payment of the dividends to the holders of the Preferred Stock and subject to the other preferences and special rights of the Preferred Stock, will inure to the benefit of the holders of the Common Stock who do not exchange their shares of Common Stock for shares of the Preferred Stock.

Assuming that all the 6,300,000 shares of Preferred Stock proposed to be authorized were to be issued in exchange for an equal number of shares of Common Stock, based on the earnings of the Corporation for the year ended December 31, 1953, the earnings per share, after such exchange, applicable to the shares of Common Stock retained by Mission Development Company, Mission Corporation and Pacific Western Oil Corporation, would have amounted to approximately \$4.12 per share as compared with \$2.75 per share prior to such exchange.

#### **FEDERAL INCOME TAX RESULTS TO COMMON STOCKHOLDERS**

The Corporation is advised by counsel that, pending issuance of Regulations under the Internal Revenue Code of 1954, it may not be possible to obtain from the Commissioner of Internal Revenue a specific ruling on the transaction, but that in the opinion of such counsel no gain or loss will be recognized to present holders of Common Stock for Federal Income Tax purposes under the Internal Revenue Code of 1954 by reason of the receipt of Preferred Stock in exchange for their Common Stock pursuant to the Plan of Recapitalization.



## **TIDE WATER ASSOCIATED OIL COMPANY**

### **PLAN OF RECAPITALIZATION**

**Dated: October 7, 1954**

1. Tide Water Associated Oil Company (hereinafter called the "Corporation"), a Delaware corporation, has an authorized capital stock consisting of 15,000,000 shares of common stock, \$10.00 par value (hereinafter sometimes called "Common Stock") and 873,779 shares of preferred stock without par value (hereinafter sometimes called "Old Preferred Stock"). As of the date hereof, there are outstanding 13,433,299 shares of Common Stock and no shares of Old Preferred Stock. As of the date of the Plan the Common Stock Capital Account of the Corporation is \$134,332,990, representing \$10.00 for each share of Common Stock outstanding; and the Capital Surplus Account \$6,927,745. As of June 30, 1954 the Retained Profits Reinvested Account of the Corporation was \$186,592,119.

2. Of the outstanding Common Stock of the Corporation 5,180,938 shares are owned and held by Mission Development Company, 377,524 shares are owned and held by Mission Corporation, and 1,557,216 shares are owned and held by Pacific Western Oil Corporation. Mission Development Company, Mission Corporation and Pacific Western Oil Corporation together own 7,115,678 shares, constituting approximately 53% of the outstanding Common Stock.

3. It is proposed to amend the Certificate of Incorporation of the Corporation to create an aggregate of 6,300,000 shares of a new cumulative preferred stock, entitled to dividend payments at the rate of \$1.20 annually, and having a par value of \$25 each (hereinafter sometimes called "Preferred Stock") in lieu of the Old Preferred Stock.

4. The designations and the powers, preferences and rights, and the qualifications, limitations and restrictions of such Preferred Stock shall be as set forth in the proposed amended Article Fourth of the Certificate of Incorporation, a copy of which is annexed hereto as Exhibit A hereof.

5. An offer will be made to the holders of the outstanding Common Stock of the Corporation, other than Mission Development Company, Mission Corporation and Pacific Western Oil Corporation, by written Offer of Exchange, to issue to such holders of outstanding Common Stock, other than Mission Development Company, Mission Corporation and Pacific Western Oil Corporation, who elect to exchange all or any part of the Common Stock of the Corporation held by them, shares of such Preferred Stock in exchange for the surrender to the Corporation for cancellation of shares of Common Stock in the ratio of one share of Preferred Stock for each share of Common Stock surrendered, subject to the formal approval by the holders of a majority of the outstanding Common Stock of this Plan of Recapitalization and the amendment to Article Fourth of the Certificate of Incorporation proposed as hereinabove described and subject to said Amendment's becoming effective. Such offer shall be open until 3:30 p.m., Eastern Standard Time, December 8, 1954. Any holder of the Corporation's Common Stock, other than Mission Development Company, Mission Corporation and Pacific Western Oil Corporation, will be given the opportunity of accepting the exchange offer by depositing for exchange all or any number of shares of Common Stock held by him. Any such stockholder will be permitted to revoke his acceptance and direct return of the deposited shares by giving notice thereof, which shall be received prior to 3:30 p.m., Eastern Standard Time, December 8, 1954. No revocation will be permitted thereafter.

6. All shares of Common Stock exchanged for Preferred Stock will be cancelled and retired by the Corporation.

7. There will be set up on the books of the Corporation as a Preferred Stock Capital Account in respect of each share of Preferred Stock issued in exchange for Common Stock, the sum of \$25.00 by transferring to such Preferred Stock Capital Account from Common Stock Capital Account in respect of each share of Common Stock received by the Corporation for exchange and surrendered for cancellation and retirement the sum of \$10.00 presently set up upon the books as the capital in respect of each share of such Common Stock, and by transferring from the Retained Profits Reinvested Account to the Preferred Stock Capital Account in respect of each such share of Preferred Stock so issued the sum of \$15.00 so that the Preferred Stock Capital Account shall equal \$25.00 per each share of Preferred Stock so issued.

8. In the event that this Plan of Recapitalization and the proposed amendment to Article Fourth of the Certificate of Incorporation are not approved by the holders of a majority of the outstanding Common Stock at a special meeting of the stockholders to be called for such purpose, or upon any adjournment or adjournments thereof, or in the event that said proposed amendment to Article Fourth of the Certificate of Incorporation shall not become effective, this Plan of Recapitalization shall not become effective and shall be inoperative.

**TIDE WATER ASSOCIATED OIL COMPANY**

**Proposed Amendment to Article Fourth  
of the  
Certificate of Incorporation**

**FOURTH:** The total number of shares of all classes of stock which the corporation shall have authority to issue is 21,300,000, of which 6,300,000 shares shall be shares of \$1.20 cumulative preferred stock of the par value of \$25 each (hereinafter called Preferred Stock) and 15,000,000 shares shall be shares of common stock of the par value of \$10 each (hereinafter called Common Stock).

A statement of the designations and the powers, preferences and rights, and the qualifications, limitations or restrictions thereof, of the shares of stock of each class which the corporation shall be authorized to issue, is as follows:

1. The holder of Preferred Stock shall be entitled to receive, and the corporation shall be bound to pay, only as and when declared by the Board of Directors and out of funds legally available for the payment of dividends, cumulative dividends, at the rate of \$1.20 per annum from the date of the issuance of said shares, and no more, payable in cash, quarterly, on the 10th days of January, April, July and October in each year, commencing with the 10th day of January 1955, provided that, in the event that any such day shall be a Saturday, Sunday, or legal holiday, such quarterly payments shall be made on the next succeeding business day. If dividends on the Preferred Stock shall be in arrears, the holders thereof shall not be entitled to any interest thereon, or sum of money in lieu of interest.

2. Upon any dissolution, liquidation or winding up of the corporation, the holders of Preferred Stock shall be entitled, before any distribution or payment is made to the holders of any class of stock ranking junior to the Preferred Stock, to be paid in respect of each share of such Preferred Stock then issued and outstanding an amount in cash equivalent to the redemption price of such Preferred Stock as provided in Section 5 of this Article Fourth, at the time of such dissolution, liquidation or winding up, as hereinafter provided, plus accrued dividends thereon to the date of payment, and no more. In case the net assets of the corporation are insufficient to pay the holders of all outstanding shares of Preferred Stock the full amounts to which they are respectively entitled, the entire net assets of the corporation shall be distributed ratably to the holders of all outstanding shares of Preferred Stock in proportion to the amounts to which they are respectively entitled. The consolidation or merger of the corporation with or into another corporation, or the sale, lease or conveyance of all or substantially all of the assets of the corporation as an entirety shall not be deemed a dissolution, liquidation or winding up of the corporation for the purposes of this Section 2 of this Article Fourth.

3. Except as otherwise required by law and subject to the provisions of Section 4 of this Article Fourth, no holder of Preferred Stock shall have any right to vote for the election of directors or for any other purpose; provided, however, that, if and when dividends on the Preferred Stock shall be in arrears and such arrears shall aggregate an amount at least equal to six quarterly dividends upon the Preferred Stock, then and in such event, and until such rights shall cease as hereinafter provided, the holders of the Preferred Stock shall be entitled at all elections of directors, voting separately as a class, to elect two members of the Board of Directors, irrespective of the number of directors at any time constituting the Board. At any meeting at which the holders of Preferred Stock voting as a class, shall be entitled to elect directors, the holders of a majority of the then outstanding shares of Preferred Stock, present in person or by proxy, shall constitute a quorum for the purpose of electing the directors which the holders of Preferred Stock shall be entitled to elect. When-

ever all arrears of dividends on the Preferred Stock shall have been paid or declared and provided for, and dividends thereon for the current quarterly period shall have been paid or declared and provided for, then the right of the holders of the Preferred Stock to vote, as provided in this Section 3 of this Article Fourth, at all elections of directors shall cease, and the respective terms of office of any and all directors theretofore elected by the vote of the holders of the Preferred Stock, as hereinabove provided, shall ipso facto cease and terminate and vacancies shall be deemed to exist in respect thereof, but subject always to the same provisions for the vesting of such voting rights in the case of any such future arrearages of dividends. In any case in which the holders of the Preferred Stock shall be entitled to vote pursuant to the provisions of this Section 3 or of Section 4 of this Article Fourth or pursuant to law, each holder of Preferred Stock shall be entitled to one vote for each share thereof held.

4. (a) Except as hereinafter provided in this Section 4 of this Article Fourth, so long as any shares of Preferred Stock are outstanding, the consent of the holders of at least two-thirds ( $\frac{2}{3}$ ) of the outstanding shares of Preferred Stock, given in person or by proxy, either in writing or at a meeting called for that purpose, at which the holders of the Preferred Stock shall vote separately as a class, shall be necessary for effecting or validating any one or more of the following:

(1) The authorization of any additional class of stock ranking prior to the Preferred Stock;

(2) The amendment, alteration or repeal of any of the provisions of the Certificate of Incorporation of the corporation or any amendment thereto or any other certificate filed pursuant to law which would adversely affect any of the preferences, special rights or powers of outstanding shares of Preferred Stock granted under this Article Fourth;

(3) The voluntary dissolution, liquidation or winding up of the corporation, unless upon such voluntary dissolution, liquidation or winding up the holders of the Preferred Stock will receive an amount in cash equivalent to the redemption price of such Preferred Stock at such time, as provided in Section 5 of this Article Fourth plus accrued dividends thereon to the date of payment;

(4) Subject to the provisions of subparagraph (b) of Section 4 of this Article Fourth, the merger or consolidation of the corporation with or into any other corporation, unless the corporation resulting from or surviving such merger or consolidation will have, after such merger or consolidation, no class of stock, either authorized or outstanding, ranking prior to the Preferred Stock (or the stock, if any, issued to holders of Preferred Stock in lieu thereof, in connection with such merger or consolidation);

(5) The giving by the corporation of any guaranty or similar obligation for the payment of any amounts by way of dividends on, or for the redemption or retirement of, the stock of any other corporation.

(b) Nothing in this Section 4 of this Article Fourth contained, however, shall be deemed to require such consent to

(1) The merger or consolidation of the corporation with or into, or the sale of all or substantially all of the assets of this corporation to, any other corporation and the authorization and issuance in connection therewith by the corporation resulting from or surviving such merger or consolidation, or to which such assets are so sold, of shares of stock ranking on a parity with the Preferred Stock (or the stock, if any, issued to holders of Preferred Stock in lieu thereof in connection with such merger or consolidation or sale of assets), in lieu of or in exchange for stock of any corporation which is a party to such merger or consolidation, or which shall purchase such assets, or in exchange for property or assets, provided that the Board of Directors of the corporation shall determine that the value per share of such stock of such corporation, or in the case of property or assets, the value thereof, shall be at least equal to the par value, if any, of the stock so issued in lieu thereof or in exchange therefor;

(2) The authorization of additional shares of Preferred Stock or of shares of stock of a class or classes ranking on a parity with the Preferred Stock and the issuance thereof for cash or for

property or assets, provided that, in the case of the issuance of any of such stock for property or assets, the Board of Directors of the corporation shall determine the value of such property or assets to be at least equal to the par value, if any, of the stock issued in exchange therefor;

(3) The amendment of the Certificate of Incorporation so as to change the dividend rates, the dividend payment dates, the redemption or liquidation prices per share or the sinking fund provisions with respect to shares of Preferred Stock which are authorized but unissued.

5. The corporation, at the option of the Board of Directors, may redeem at any time, or from time to time, any Preferred Stock at the following redemption prices per share plus accrued dividends thereon to the date fixed for redemption: if redeemed on or before January 10, 1956, \$30.00; if redeemed after January 10, 1956 but on or before January 10, 1957, \$29.00; if redeemed after January 10, 1957 but on or before January 10, 1958, \$28.00; if redeemed after January 10, 1958 but on or before January 10, 1959, \$27.00; if redeemed after January 10, 1959 but on or before January 10, 1960, \$26.00; if redeemed after January 10, 1960, \$25.00; provided, however, that, not less than thirty days previous to the date fixed for redemption, a notice of the time and place thereof shall be given to the holders of record of the shares of Preferred Stock so to be redeemed, by mailing a copy of such notice to such holders at their respective addresses as the same appear upon the books of the corporation. In case of redemption of less than all of the outstanding Preferred Stock, such redemption shall be made pro rata or the shares to be redeemed shall be chosen by lot, in such manner as the Board of Directors may determine.

At any time after notice of redemption has been given in the manner herein prescribed, or after the corporation shall have delivered to any bank or trust company having its principal office in the Borough of Manhattan, City and State of New York, an instrument in writing irrevocably authorizing such bank or trust company to give notice of redemption of all or any part of the outstanding Preferred Stock in the name of the corporation and in the manner herein prescribed, the corporation may deposit the amount of the aggregate redemption price, plus the amount of such accrued dividends, with any such bank or trust company named in such notice, in trust for the holders of the shares so to be redeemed, payable, on the date fixed for redemption as aforesaid and in the amounts aforesaid, to the respective order of such holders, upon endorsement to the corporation or otherwise as may be required and upon surrender of the certificates for such shares. Upon the deposit of the aggregate redemption price plus the amount of such accrued dividends as aforesaid, or if no such deposit is made, upon said date fixed for redemption (unless the corporation shall default in making payment of the redemption price plus such accrued dividends as set forth in said notice) such holders shall cease to be stockholders with respect to said shares and shall be entitled only to receive the redemption price plus such accrued dividends on the date fixed for redemption as aforesaid, from such bank or trust company or from the corporation, without interest thereon, upon endorsement, if required, and the surrender of the certificates for such shares, as aforesaid; provided that any funds so deposited by the corporation and unclaimed at the end of six years from the date fixed for such redemption shall be repaid to the corporation upon its request, after which repayment the holders of such shares so called for redemption shall look only to the corporation for payment of the redemption price thereof plus such accrued dividends. Any funds so deposited which shall not be required for such redemption shall be returned to the corporation forthwith. Any interest accrued on any funds so deposited shall belong to the corporation and shall be paid to it from time to time.

Subject to the provisions hereof, the Board of Directors shall be authorized to prescribe the manner in which Preferred Stock shall be redeemed from time to time. No shares of Preferred Stock which shall have been redeemed or which shall have been purchased by the application of capital or otherwise retired pursuant to the provisions of the General Corporation Law of the State of Delaware shall be reissued or resold.

6. In no event, so long as any of the Preferred Stock shall be outstanding, shall any dividend whatsoever, whether in cash, property or otherwise, except dividends or distributions payable in shares of stock of a class ranking junior to the Preferred Stock, be declared or paid, or any distribution be



made, on any stock of the corporation of a class ranking junior to the Preferred Stock, nor shall any shares of any such junior class of stock be purchased or redeemed by the corporation, nor shall any moneys be paid to or set aside or made available for a purchase fund or sinking fund for the purchase or redemption of any shares of any such junior class of stock, except from earned surplus of the corporation accumulated subsequent to December 31, 1953, and unless (a) all dividends on all the Preferred Stock then outstanding for all past dividend periods shall have been paid, or declared and provided for and the full dividends for the then current quarterly dividend period shall have been paid or declared and provided for, and (b) the corporation shall have paid or set aside all amounts, if any, theretofore required to be paid or set aside as and for the sinking fund for the Preferred Stock for the then current semi-annual period, and all defaults, if any, in complying with the sinking fund requirements in respect of previous fiscal years shall have been made good.

7. So long as any shares of Preferred Stock shall be outstanding, the corporation shall, on or before June 10 and December 10 in each year, commencing with June 10, 1960, set apart in cash, as and for a sinking fund for the redemption of the Preferred Stock, such amount as will be required to redeem on the July 10 or January 10, whichever shall first occur, next ensuing, at the sinking fund redemption price of \$25.00 per share, plus accrued dividends thereon to the date fixed for redemption, such number of whole shares of Preferred Stock as shall equal, to the nearest fraction,  $1\frac{1}{4}\%$  of the greatest number of shares of Preferred Stock theretofore at any time outstanding, and shall, on each such January 10 and July 10, redeem such number of shares of Preferred Stock in the manner and with the effect provided in Section 5 of this Article Fourth, except that the redemption price shall be the sinking fund redemption price hereinabove in this Section 7 specified in lieu of the redemption price provided in said Section 5; provided, however, that in lieu of setting aside any such amount in cash, or any part thereof, and so redeeming any shares of Preferred Stock, the corporation, on or before the date on which any such amount is required to be so set aside pursuant to this Section 7 of this Article Fourth, may purchase and set aside for cancellation shares of Preferred Stock, in which event the number of shares of Preferred Stock required, pursuant to this Section 7 of this Article Fourth, to be so redeemed on the January 10 or July 10, as the case may be, next ensuing, shall be reduced by the number of shares of Preferred Stock so purchased and set aside, and the amount in cash so required to be set aside as and for a sinking fund for the Preferred Stock shall be reduced by an amount equivalent to the sinking fund redemption price, plus such accrued dividends, which would have been required to be so set aside in cash pursuant to this Section 7 of this Article Fourth in respect of such number of shares of Preferred Stock so purchased and set aside in the event that the same had not been so purchased and set aside.

8. The failure of the corporation to pay any dividend or arrearages of accumulated dividends on the Preferred Stock or to pay or set aside any amount required to be paid or set aside as and for a sinking fund for the Preferred Stock, or to redeem any Preferred Stock pursuant to the provisions of this Article Fourth, or to make good any default in complying with the sinking fund requirements shall not give rise to any rights in the holders of the Preferred Stock or impose upon the corporation any liabilities or disabilities, except as herein, in this Article Fourth, specifically provided.

9. No shares of Preferred Stock which shall have been redeemed through the operation of the sinking fund, or for which credit against the sinking fund requirements shall have been taken, shall be applied against any subsequent sinking fund requirement or reissued or resold.

10. Subject to the prior rights of the Preferred Stock and to the limitations set forth in Section 6 of this Article Fourth, dividends may be paid upon the Common Stock as and when declared by the Board of Directors out of funds legally available for the payment of dividends.

11. Upon any dissolution, liquidation or winding up of the corporation, whether voluntary or involuntary, after the holders of the Preferred Stock shall have been paid the full amounts to which



they are respectively entitled, the remaining net assets of the corporation shall be distributed ratably to the holders of Common Stock.

12. Except as otherwise expressly provided in Sections 3 and 4 of this Article Fourth, and except as otherwise may be required by law, the Common Stock shall have the exclusive right to vote for the election of directors and for all other purposes, each holder of Common Stock being entitled to one vote for each share thereof held.

13. For the purposes of this Article Fourth,

(a) The terms 'accrued dividends', 'dividends accrued', 'dividends in arrears' and similar terms shall mean, in respect of each share of Preferred Stock, an amount equal to thirty cents (\$.30) for each quarterly dividend payment date which shall have elapsed from the date on which dividends on such share became cumulative, less the aggregate amount of dividends paid thereon;

(b) Any class or classes of stock of the corporation shall be deemed to rank

(1) Prior to the Preferred Stock, if the holders of such class or classes shall be entitled to the receipt of dividends or of amounts distributable on any dissolution, liquidation or winding up, as the case may be, in preference to or with priority over the holders of the Preferred Stock;

(2) On a parity with the Preferred Stock, whether or not the dividend rates, dividend payment dates or redemption or liquidation prices per share thereof be different from the Preferred Stock, if the rights of the holders of such class or classes to the receipt of dividends or of amounts distributable upon any dissolution, liquidation or winding up, as the case may be, shall be neither in preference to or with priority over, nor subject or subordinate to the rights of the holders of the Preferred Stock in respect of the receipt of dividends or of amounts distributable upon any dissolution, liquidation or winding up, as the case may be; and

(3) Junior to the Preferred Stock, if the rights of the holders of such class or classes shall be subject or subordinate to the rights of the holders of the Preferred Stock in respect of the receipt of dividends or of amounts distributable upon any dissolution, liquidation or winding up, as the case may be.

14. No stockholder of the corporation shall have any preemptive or preferential right of subscription to any shares of any class of stock of the corporation, whether now or hereafter authorized, or to any obligations convertible into stock of the corporation, issued or sold, nor any right of subscription to any thereof other than such, if any, and at such price as the Board of Directors, in its discretion from time to time may determine, pursuant to the authority hereby conferred by the Certificate of Incorporation, and the Board of Directors may issue stock of the corporation or obligations convertible into stock without offering such issue of stock either in whole or in part to the stockholders of the corporation, and no holder of Preferred Stock of the corporation shall have any preemptive or preferential right to receive any of such shares or obligations declared by way of dividend. Should the Board of Directors as to any portion of the stock of the corporation, whether now or hereafter authorized, or to any obligations, convertible into stock of the corporation, offer the same to the stockholders or any class thereof, such offer shall not in any way constitute a waiver or release of the right of the Board of Directors subsequently to dispose of other portions of said stock without so offering the same to the stockholders. The acceptance of stock in the corporation shall be a waiver of any such preemptive or preferential right which in the absence of this provision might otherwise be asserted by stockholders of the corporation or any of them.

15. Except as herein otherwise provided, any unissued shares of stock of any class, herein authorized or hereafter increased or created, may be issued from time to time by the corporation in such

manner, amounts and proportions and for such consideration as shall be determined from time to time by the Board of Directors and as may be permitted by law; and all issued shares of the capital stock of the corporation shall be deemed fully paid and non-assessable and the holders of such shares shall not be liable thereunder to the corporation or its creditors.

16. With the affirmative vote or written consent of the holders of at least a majority of the Common Stock of the corporation then issued and outstanding, the Board of Directors may at any time or from time to time authorize or approve a stock purchase plan or plans providing for the issue and sale to any or all of the employees, including officers, of the corporation or of any company in which the corporation owns a majority of the issued voting stock, of any shares of Common Stock of the corporation at such price and on such other terms and conditions as the Board of Directors shall determine and as may be permitted by law; provided, however, that any shares of Common Stock of the corporation subscribed for prior to October 15, 1936, under and pursuant to any stock purchase plan or plans authorized or approved by the Board of Directors prior to said date, may be issued and sold, without the necessity of such vote or written consent, in accordance with the provisions of such stock purchase plan or plans.

17. The corporation shall be entitled to treat the person in whose name any share is registered as the owner thereof, for all purposes, and shall not be bound to recognize any equitable or other claim to, or interest in, such share on the part of any other person, whether or not the corporation shall have notice thereof, save as expressly provided by the laws of the State of Delaware.

[fol. 174a]

IN UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

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No. 51—October Term, 1960

Argued November 1, 1960

Docket No. 25846

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ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company, Plaintiff-Appellant-Appellee,

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of LEHMAN BROTHERS, Defendants-Appellees,

JOSEPH A. THOMAS, Defendant-Appellee-Appellant,  
and

TIDE WATER ASSOCIATED OIL COMPANY, Defendant-Appellee.

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[fol. 175a] Before: Swan, Clark and Medina, Circuit Judges.

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Cross-appeals from a judgment of the United States District Court for the Southern District of New York. Archie O. Dawson, Judge.

In an action by a stockholder of Tide Water Associated Oil Company for recovery of short swing profits against

Joseph A. Thomas, a director, and against Lehman Brothers, a partnership composed of Joseph A. Thomas and others, based upon Section 16(b) of the Securities Exchange Act of 1934, the complaint was dismissed as against Lehman Brothers and a recovery allowed against Joseph A. Thomas for \$3,893.41, the share of the firm profits from the purchase and sale of Tide Water Associated Oil Company stock found to have been "realized," although "waived" and not received by Thomas, but without interest. Cross-appeals by plaintiff and by Joseph A. Thomas. Opinion below reported in 173 F. Supp. 590. Affirmed.

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Morris J. Levy, New York, N. Y., for plaintiff-appellant-appellee.

Cyrus R. Vance, New York, N. Y. (Robert S. Carlson and Simpson Thacher & Bartlett, New York, N. Y., on the brief), for defendants-appellees (other than Tide Water Associated Oil Company) and Joseph A. Thomas, defendant-appellee-appellant.

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OPINION—December 20, 1960

MEDIA, *Circuit Judge*:

In this action by a stockholder of Tide Water Associated Oil Company brought under Section 16(b) of the Securities [fol. 176a] Exchange Act of 1934, 15 U. S. C. Section 78p (b),<sup>1</sup> to recover on Tide Water's behalf short swing profits

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<sup>1</sup> §16(b), 15 U. S. C. §78p(b) reads as follows:

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period

alleged to have been realized by Joseph A. Thomas, a director of Tide Water, and by Lehman Brothers, a partnership of investment bankers and stockbrokers, of which Thomas was a member, the complaint was dismissed as against all the partners other than Thomas, after a trial by the court without a jury, and judgment was entered against him for only \$3,893.41 and costs. The trial judge computed the profits of Lehman Brothers at \$98,686.77 but refused to direct judgment against Thomas for more than the amount which was, despite his claim that he had received no part of the profits, found to have been "realized by him." The method of computing the profits was also matter of dispute between the parties. Plaintiff and Thomas have filed cross-appeals. The opinion below is reported in 173 F. Supp. 590. [fol. 177a] On August 5, 1954 Thomas, then a partner of Lehman Brothers, became a director of Tide Water. Although he succeeded John Hertz, also a partner of Lehman Brothers, Judge Dawson, after a careful and comprehensive review of the testimony, found that "the invitation to join the Tide Water Board was upon the initiative of Tide Water." He also found "there was no evidence that the firm of Lehman Brothers deputed Thomas to represent its interests as a director on the board of Tide Water."

On September 17, 1954 public announcement was made in the Wall Street Journal that Tide Water was considering a proposal to allow shareholders to exchange common stock for a new dividend-paying preferred stock; and on October 8, 1954 it was announced in the Wall Street Journal that

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exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

such a proposal had been approved by the directors. Immediately after this last announcement and on the same day Lehman Brothers, "acting solely on the basis of Tide Water's public announcements and without consulting Thomas with reference thereto," decided to purchase 50,000 shares of Tide Water common stock for the purpose of converting them into the new preferred stock and selling the preferred stock to institutional investors. Thomas had provided no confidential information whatever; and he did not even know the transaction concerning the 50,000 shares of Tide Water stock was under consideration by the Portfolio Committee of Lehman Brothers until the sales slips appeared upon his desk, after the first few thousand shares had been purchased. In response to his inquiry about this he was told that 50,000 shares of Tide Water common were to be bought, converted into preferred and sold. Immediately thereafter Thomas instructed the firm controller "to exclude me from any risk of the purchase or any profit or loss from the subsequent sale and to take the necessary steps to carry out my instructions." At a meeting of the partners the following Monday he told the other partners [fol. 178a] that he wanted them to know that he was "not a part of this Tide Water transaction at all," and they agreed. He later filed SEC Form 4 from time to time setting forth all the facts required to be reported, explaining that these were "transactions and holdings of Lehman Brothers a partnership of which I am a member. I have previously waived all interests in a total of 50,000 of these shares."

Between October 8, 1954 and November 15, 1954 Lehman Brothers purchased the 50,000 shares of Tide Water common stock for \$1,330,800. Pursuant to the contemplated plan of recapitalization, Lehman Brothers on December 8, 1954 exchanged its 50,000 shares of common stock for 50,000 shares of a new preferred stock issued by Tide Water. Between December 9, 1954 and March 8, 1955 Lehman Brothers sold its 50,000 shares of preferred stock for \$1,361,186.77. Out of the profits on this series of transactions within a period of six months Thomas received nothing, as his share of the partnership profits was calculated in accordance with his instructions to the firm con-



troller and his oral agreement with his partners to the effect that he was to be cut out of the Tide Water venture.

### *The Claim Against Lehman Brothers*

Plaintiff argues that judgment for the full amount of \$98,686.77 should have been rendered against Lehman Brothers. On this phase of the case the contentions of the parties revolve about the decision of this Court in *Rattner v. Lehman*, 2 Cir., 1952, 193 F. 2d 564. While plaintiff does not state in so many words that he asks us to reconsider our rulings in that case, such is the purport of much that is argued in plaintiff's briefs, and I shall assume that the contention is: (1) that the decision in *Rattner* is unsound and the case should be overruled; and (2) that this case is distinguishable on the facts from *Rattner*.

[fol. 179a] In that case John D. Hertz, a partner of Lehman Brothers, was a director of Consolidated Vultee Aircraft Corporation. The firm had made short swing profits on the purchase and sale of Consolidated Vultee common stock. Of these profits Hertz received \$806.62 which he turned over to Consolidated Vultee. We refused to hold Lehman Brothers liable for the profits realized by the firm on the ground that Section 16(b) "contains no provision requiring the partners of a director to account for profits realized by them." In answer to the argument that this leaves a loophole in the law Judge Swan, writing for the court, observed that the omission of any provision for such liability "was intentional," as the legislative history of Section 16(b) indicated that a clause in the earlier drafts imposing such liability had been "eliminated from the statute as finally enacted." I feel bound by this ruling, especially since it has been in force for some eight years and the Congress has not seen fit to amend the statute; and Judge Swan and I vote to affirm the judgment in favor of Lehman Brothers on the authority of *Rattner*.

The alleged distinction between this case and *Rattner* on the question of the liability of the partnership is based upon a dictum by Judge Learned Hand in his concurring opinion in *Rattner*, to the effect that he agreed that Section 16(b) did not apply, "but I wish to say nothing as to whether, if

a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable." Plaintiff in the case before us argues that there is ample proof that director Thomas was deputed by Lehman Brothers to represent its interests as a director on the board of Tide Water; but the trial judge states that he finds no such evidence in the case.

To begin with, Judge Swan and I do not agree with this dictum, as we must take Section 16(b) as we find it, and we do not see how any sort of deputizing can make the part-[fol. 180a] ners or the partnership a "director" within the meaning of Section 16(b). But we do not have to decide the question, because the evidence in this case will not support an inference that Lehman Brothers deputized Thomas to represent its interests as director on the board of Tide Water. Doubtless the firm was pleased to have Thomas succeed Hertz as a director, and so was John Schiff, of Kuhn, Loeb & Company, who introduced his friend Thomas to David T. Staples, president of Tide Water who thereafter invited Thomas to become a director. However, there is no evidence of any deputizing or other affirmative action by the firm to cause Thomas to be made a director to protect the interests of the firm or to become its representative.

Reference is made in plaintiff's brief to certain general statements in the findings contained in the opinion in *United States v. Morgan, et al.*, D. C. S. D. N. Y., 1953, 118 F. Supp. 621. These must be understood against the background of the entire history of the investment banking business in the United States that was in one way or another involved in the comprehensive and exceedingly complicated charges of conspiracy to violate the Anti-trust laws. Thus, in reference to a time prior to World War I, when there was a sort of informal working arrangement between Goldman, Sachs & Co. and Lehman Brothers, the opinion states (p. 639):

"With this background, it is easy to see that many of the issuers, especially those whose securities were not well known to the public, leaned heavily upon the sponsorship of the investment banking firms under whose auspices the securities were sold. Issuers invited partners or officers of investment banking firms to serve

on their boards of directors, in order to interest investors in their securities. Some of the prospectuses, which in those early days were little more than notices, stated that a partner or officer of a particular investment [fol. 181a] banking firm would go on the board of directors of the issuer whose securities were being offered to the public for sale. Investment bankers sometimes asked to be put on the boards of directors of issuers in order to know how they were managed and to protect the interests of the investors to whom they had sold the issuer's securities. Since the investment bankers sponsored the securities and lent their names to their sale, they felt a certain obligation to the investors to whom they sold the securities to see to it that the issuers did not adopt any policies or engage in any practices which would impair the value of those securities. This was especially important in connection with foreign investors."

But general statements are of little assistance in the decision of particular issues. The fact that Thomas succeeded Hertz as a director of Tide Water, and the circumstance that there were other instances where one partner of Lehman Brothers succeeded another as a director in companies other than Tide Water, in the face of the credible and uncontradicted specific proof of the conversations that led up to the invitation by Staples to Thomas to become a director of Tide Water, are of no probative force whatever. Moreover, I do not think *Lehman, et al. v. Civil Aeronautics Board*, D. C. Cir., 1953, 209 F. 2d 289, cert. denied, 1954, 347 U. S. 916, has any bearing on the case before us.

For the above stated reasons Judge Swan and I find nothing here to distinguish this case from *Rattner*, which requires an affirmance of the judgment dismissing the case as against Lehman Brothers.

### *The Claim Against Joseph A. Thomas*

Insofar as plaintiff seeks a judgment against Thomas for the full amount of the profits realized by Lehman Brothers [fol. 182a] on the Tide Water venture, this was one of the

points decided in *Rattner* and Judge Swan and I are content to follow that ruling. Here again, however, plaintiff claims the present case is distinguishable from *Rattner*. He relies upon a statement in the opinion of Judge Swan that both sides had assumed the stock purchases and sales were made without the knowledge of Hertz, and (193 F. 2d at 565) "Whether the result might be different had he caused the firm to make them, we need not now determine." Plaintiff in the case now before us insists that the proofs clearly demonstrate that director Thomas did cause Lehman Brothers to enter into the Tide Water stock venture, despite the findings of the trial judge to the contrary. We see no basis whatever for a decision by us that this finding of the trial judge is clearly erroneous. Indeed, it is the only finding permissible, as the trial judge believed the testimony adduced by Lehman Brothers to prove that director Thomas had revealed no confidential information whatever, and that he not only did not induce the firm to enter the venture, he had no knowledge that the matter was even under consideration. True he did say to some of his partners and to others as well that he liked the management of Tide Water and thought its general objectives were first-rate, but this is a far cry from the giving of confidential information concerning the forthcoming proposal for recapitalization by the exchange of common stock for a new dividend-paying preferred stock or otherwise causing or inducing the firm to purchase the stock. So, we must reach the same conclusion we did in *Rattner*: whether the result might be different had Thomas caused the firm to enter the Tide Water venture we need not now determine.

Judge Dawson held Thomas for the amount of the profits he would have received had he not attempted to disassociate himself from the 50,000 share transaction and waive his share of the profits. I agree with Judge Dawson that the [fol. 183a] profits for which he has been held accountable were, in contemplation of law, "realized by him."

This phase of the case presents an interesting and important question of novel impression that was left open in *Rattner* as Hertz did not resort to any waiver and disclaimer, as did Thomas in the case before us, and he had already voluntarily paid over to the corporation the \$806.62

received by him as his share of the short swing profits of Lehman Brothers on the purchase and sale of Consolidated Vultee stock. This is not a question of New York partnership law, nor a question of Income Tax law, but rather and solely, as I see it, a question of the interpretation we are to give to a federal statute, Section 16(b).

I hold that when a partnership, one of the partners of which is a director of a corporation, makes short swing profits in speculative buying and selling of the stock of that corporation, the director must be said to have realized the share of the profits to which he would be entitled, irrespective of any waiver or disclaimer by him. Whether or not he actually receives his share of these profits is immaterial; he has "realized" profits and must account for them.

There is only one way to prevent stock manipulation by insiders to whom confidential information is available, and that is to squeeze every possible penny of profit out of such transactions. This has been held to be the clear purpose of Section 16(b), a "broadly remedial statute." *Smolowe v. Delendo Corp.*, 2 Cir., 136 F. 2d 231, 239, cert. denied, 1943, 320 U. S. 751. One way to do this was to construe Section 16(b) to include the partnership because of the unity of the partnership relationship and the fact that one of the partners is a director. But *Rattner* decided otherwise, and that is water over the dam as far as I am concerned. If we now hold that the director himself can escape by the mere device of a waiver and disclaimer, we [fol. 184a] shall have opened a breach in the law through which stockbrokers and investment banking houses, those most likely to be in a position to profit by the use of confidential information in stock speculation, can pass with impunity.

While no confidential information was improperly used in this case, we must bear in mind that the statute is designed to affect cases where confidential information might be used. Moreover, to permit a waiver and disclaimer to immunize the director would almost certainly lead to wholesale waivers and disclaimers by the various partners who are directors of corporations, with the result that the

profits waived by one partner would increase the profits of the others and in the end each would have about the same amount of profits he would have received from such transactions had there been no waiver and disclaimer. When the Congress passed Section 16(b) it was never intended to permit any such merry-go-round as this.<sup>2</sup>

*The Method of Computing the "Profits  
Realized by" Thomas*

The 50,000 shares of common stock of Tide Water were purchased by Lehman Brothers between October 8, 1954 and November 15, 1954; they were converted into the new preferred stock on December 8, 1954; and the 50,000 shares of new preferred stock were sold between December 9, 1954 and March 8, 1955. Thus all of these transactions occurred within the short swing period of six months specified in [fol. 185a] Section 16(b). If the conversion into the preferred stock constituted a "purchase" under Section 16(b) the profits amounted to \$98,686.77, and the amount of these profits "realized" by Thomas was \$3,893.41, as held by Judge Dawson. But Thomas contends that the conversion was not a "purchase" and that the profit must be computed by subtracting the cost of the shares of common stock from the amount received on the sale of the preferred stock, or \$30,386.71.

We are not, however, computing profits in accordance with what might be the custom of traders and speculators in the stock market. We are construing a federal statute designed to prevent certain persons, including directors and officers, from making short swing profits by "the unfair use of information" available to them because of their

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<sup>2</sup> There is some evidence of this here. During cross examination the defendant Thomas was asked:

"Q. Is it customary for a partner who is a director in a corporation to waive his interests in the short swing profits realized by a corporation?"

He answered:

"A. I think customary is a pretty strong word. But all of us are aware of the existence of 16(b) and you certainly wouldn't want to find yourself in that predicament."



confidential relationship to the corporation. The cases present the problem of what is a "purchase" in a great variety of factual combinations. But the underlying principle, as I understand it, is that the transaction is a "purchase" if in any way it lends itself to the accomplishment of what the statute is designed to prevent. The leading case is *Park & Tilford, Inc. v. Schulte*, 2 Cir., 160 F. 2d 984, cert. denied, 1947, 332 U. S. 761. While we held the transaction not to be a "purchase" in *Roberts v. Eaton*, 2 Cir., 1954, 212 F. 2d 82, the same line of reasoning was used.<sup>3</sup> What was done in that case did not lend itself to the furtherance of the prohibited purpose. There is no rule of thumb; nor would it be wise to attempt to formulate such a rule.

[fol. 186a] Here the acquisition of the preferred stock was in all respects voluntary; Lehman Brothers had the choice of retaining its common stock or exchanging it for preferred stock. The stock of Tide Water was registered on the New York Stock Exchange and was widely held by the public. When the common was acquired the success of the Lehman Brothers Tide Water venture still depended on future shareholder approval. It was only after approval, the issuance of the preferred stock and the exchange that the profits were realized. The exchange constituted a necessary step to the consummation of the plan. We cannot say that such a situation did not lend itself to manipulation and to the making of short swing profits within the meaning of Section 16(b). We hold the exchange was a "purchase" and that the profits realized were properly computed by Judge Dawson.

### *Interest*

Judge Dawson refused to allow interest on the recovery against director Thomas. It is well settled that the allowance of interest in Section 16(b) cases is not manda-

<sup>3</sup> See also *Ferraiolo v. Newman*, 6 Cir., 1958, 259 F. 2d 342, 345, cert. denied, 1959, 359 U. S. 927; *Blau v. Mission Corp.*, 2 Cir., 1954, 212 F. 2d 77; *Shaw v. Dreyfus*, 2 Cir., 172 F. 2d 140, cert. denied, 1949, 337 U. S. 907; *Blau v. Lamb*, D. C. S. D. N. Y., 1958, 163 F. Supp. 528, 534; *Blau v. Hodgkinson*, D. C. S. D. N. Y., 1951, 100 F. Supp. 361; *Truncate v. Blumberg*, D. C. S. D. N. Y., 1948, 80 F. Supp. 387.

tory. *Magida v. Continental Can Co.*, 2 Cir., 1956, 231 F. 2d 843. Judge Swan and I do not believe it was an abuse of judicial discretion to refuse such an allowance of interest in this case.

**Affirmed.**

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SWAN, *Circuit Judge* (dissenting in part):

I agree with my brother Medina to affirm the judgment insofar as it dismissed the action as against the partners, other than Thomas, of Lehman Brothers. With respect to Thomas, I think he should be held liable in an amount less than the judgment against him awarded Tide-water.

[fol. 187a] In my opinion we should differentiate between the shares of Tide-water stock purchased *before* and those purchased *after* Thomas, with his partners' consent, withdrew from any participation in the partnership purchases of such stock. As to profits attributable to the shares purchased before Thomas' withdrawal, I think it reasonable to hold that Thomas could not relieve himself from liability by transferring to the other partners his share of such profits and, consequently, he can be held to have "realized" such profits within the meaning of the statute. But this argument is inapplicable to the shares purchased after Thomas withdrew. It is my understanding that a partnership agreement can be modified by parol so as to exclude one partner from participating in investments or sharing in the profits or losses on investments made subsequent to the modification. As to profits attributable to the *after*-purchased shares, Thomas had no interest to transfer to Lehman Brothers and I do not see how he can be held to have "realized" any profit on such shares. Consequently I think on Thomas' appeal the cause should be remanded for determination of the correct amount of the judgment to be awarded against him. As to the method of computing the profits and the non-allowance of interest I agree with my brother Medina.

CLARK, *Circuit Judge* (dissenting):

Against the background of "a widely condemned evil," §16(b) of the Securities Exchange Act of 1934 put teeth into the concept of a corporate director's fiduciary obligation by the simple but arbitrary course of requiring him to disgorge to his corporation "insider" profits from stock speculation obtained under stated circumstances and without regard to his own good faith or innocence. This device has worked successfully where more refined methods might [fol. 188a] have failed; and although the provision "is probably the most cordially disliked provision in all these statutes from the point of view of those whom it affects," Loss, Securities Regulation 578 (1951), yet its policy is so important and so generally approved that repeal seems unlikely, *id.* 579; Cook & Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 612, 641 (1953). In our first case construing it we said, "The statute is broadly remedial," and went on to say: "We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty." *Smolowe v. Delendo Corp.*, 2 Cir., 136 F. 2d 231, 239, 148 A. L. R. 300, certiorari denied *Delendo Corp. v. Smolowe*, 320 U. S. 751. That principle has since shaped our statutory interpretation as well as that of other courts and is restated in our latest and full opinion in *Adler v. Klawns*, 2 Cir., 267 F. 2d 840.

To this uniform interpretation there appears to have been one notable exception, the decision relied on as authoritative here, *Rattner v. Lehman*, 2 Cir., 193 F. 2d 564. That case held that where a director was fortunate enough to be a partner in a brokerage firm which did the actual trading, he and his partners were relieved of liability for insiders' profits perhaps in all cases, but in any event in nearly all. The decision below, affirmed by my brother Medina, goes far to complete the process of complete immunity toward which my brother Swan, with relentless logic, tends. I think the principle is anomalous in granting

exemption in the very cases where the incentive to take insiders' profits is strongest as a part of a trading firm's normal business and where exception is the most difficult to understand. So I believe we should review the ruling [fol. 189a] in the light of experience and the present-day situation. And at the very least we should request assistance in the form of a brief *amicus curiae* from the S. E. C., which has often been most helpful on mooted issues in the past, but which has here not allayed, but has rather added to, the confusion, as I point out hereinafter.

I suggest that re-examination of the *Rattner* precedent is indicated for several reasons: the circumscribed nature of the discussion there had; the teaching of later experience; the equivocal position of the S. E. C.—now apparently clarified contra to the decision; and the confusion as to its possible scope and real or apparent exceptions. My own conclusion is that the case should be overruled or at least limited and that the partners here, including Thomas, should be required to pay Thomas' company the profits they made from short-swing trading in its stock.

The *Rattner* decision appears to be supported on three grounds, two of them stated in the opinion and a third adduced by later commentators. First reliance is placed upon a "literal reading" of the statute. But any reading, literal or otherwise, can hardly avoid the legal meaning of "owner" or eliminate the basic principles of partnership. Under these principles, clearly stated in New York law as embodied in the Uniform Partnership Act, property bought with partnership funds is partnership property, and a partner is co-owner with his partners of specific partnership property holding as a tenant in partnership with an equal right with his partners to possession of specific partnership property and with an equal share in the profits and surplus. N. Y. Partnership Law §§12, 40, 43, 50-52. Moreover, the partnership is charged with knowledge of or notice to a partner. *Id.* §23. I submit that on a literal legal reading of the statute, Thomas was co-owner with all the other partners of the TideWater stock when bought and of the profits when sold, and that Thomas stood at all [fol. 190a] times legally charged with full knowledge of what was going on in his firm, just as the other partners

had like knowledge. Further, I do not doubt that in any ordinary well run partnership, the practical facts of life actually coincide with these legal facts, and that one partner either actually knows what is going on in his group or is content to leave action to his colleagues. In any event, the legal situation seems clear—so much so that in my view co-owners cannot be excluded from the operation of the statute without a serious distortion of its terms. Furthermore to close the gap now opened up would require rather awkward and seemingly superfluous phraseology, such as that "owner" actually does include "co-owner."

A second ground of support for the decision was deduced from the legislative history and from the fact that a provision in earlier drafts which had made liable any person who acted on confidential information disclosed by a director was eliminated from the statute as finally enacted. But as the S. E. C. pointed out in its brief *amicus curiae* in *Rattner*, this history, so far as pertinent, really points the other way and in favor of an automatic application of the statute without the necessity of proving the parties' intent. That, too, is the view of the legislative history we emphasized in *Smolowe v. Delendo Corp.*, *supra*, 2 Cir., 136 F. 2d 231, 235, 236. But the *Rattner* decision forces for this important class of cases the very step which we felt Congress had avoided, namely, a "subjective standard of proof, requiring a showing of an actual unfair use of inside information." 2 Cir., 136 F. 2d 231, 236.

The third ground of support, adduced by some commentators, 25 So. Calif. L. Rev. 475, 478 (1952), 100 U. of Pa. L. Rev. 463, 465 (1951),<sup>1</sup> is the harshness in result of [fol. 191a] the contrary conclusion. Passing the question whether Congressional intent is to be thus limited, one may question whether this is not an attack on the entire statutory policy which is somewhat misdirected when leveled only at a single consequence as here. Admittedly the statute operates stringently, with burdensome results to individ-

<sup>1</sup> Other comments on the decision appear in Loss, *Securities Regulation* 585 (1955 Supp.), and Cook & Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 391, 403, 633-634 (1953).

uals, in many, possibly most, cases. But that seems not a sound reason for excepting its operation in this important and natural field of operation. True, the amounts involved may be large, as is to be expected from the high financial character of the protagonists naturally involved in the trading by Wall Street investment firms. But that may be easily taken as an argument for application of the statute here.<sup>2</sup> I think the exemption of these firms would be hard to explain to the ordinary small-scale director not so exempt and indeed to the investing public generally.

But if the requirement of a subjective standard of proof is to stand, then the question at once arises as to how much. And here the *Rattner* case did at least suggest the possibility of some limitation. The majority expressly declined to consider whether the result might be different had the partner "caused" the firm to make the short-swing transactions. Judge L. Hand in an obviously worried concurrence went further and, assuming for his disposition of the case that the firm had bought and sold the shares without any advice or concurrence by the director-partner, intimated that the result might be different if a firm deputed a partner to represent its interests as a director [fol. 192a] on the board. Here the evidence of director-participation is rather sharper than Judge Medina intimates and goes so far that it is hard to see what more the director could have done to assist his partners short of doing the trading himself. For in his deposition Thomas stated that he had suggested to his partners "from time to time that I thought TideWater under the new management was an attractive investment" and again, "When the new management came in, my opinion was asked of what I thought of it, and after I watched them in, I expressed my

<sup>2</sup> Enforcement of strict accounting and refund against corporate fiduciaries is not exactly a novel legal idea. See *Gratz v. Claughton*, 2 Cir., 187 F. 2d 48, 49, certiorari denied 341 U. S. 920; *Berner v. Equitable Office Bldg. Corp.*, 2 Cir., 175 F. 2d 218; *Nichols v. S. E. C.*, 2 Cir., 211 F. 2d 412, 417-418; *Surface Transit, Inc. v. Saze, Bacon & O'Shea*, 2 Cir., 266 F. 2d 862, 868; *In re Midland United Co.*, 3 Cir., 159 F. 2d 340; *Woods v. City Nat. Bank & Trust Co. of Chicago*, 312 U. S. 262, 268; Loss, Securities Regulation 594 (1955 Supp.).



opinion freely that I thought the management was first-rate, that the company would do well under that management." He also said that one of the partners with whom he discussed the TideWater management after he became a director was Mr. Hammerslough, the trading partner who actually directed the firm's purchases of TideWater stock; and Hammerslough himself testified on deposition that after Thomas became a director he "spoke very highly of the management and prospects of the TideWater Oil Company. I believe he thought very highly of it." Unless judges are to be in edibly naive as to the facts of financial life, it is difficult to see what Thomas needed to say more to show that the lily was already gilded. The facts as to the proposed TideWater exchange were published in the Wall Street Journal so that further details as to that would have been quite superfluous. In fact I regard all this discussion whether or not the firm "deputed" its members to sit on many corporate boards as naive. Obviously this was an arrangement of mutual benefit to both sides; what difference can it make in realities which extended the first invitation? And what further official "deputation" is needed more than the mere fact of this mutually beneficial management? So unless *Rattner* is to afford exemption in almost all situations of financial importance, we must reverse [fol. 193a] to hold that the suggested exceptions here apply to support firm liability.

In this situation the S. E. C. has not yet afforded us its accustomed assistance. In the *Rattner* case its general counsel filed a brief *amicus curiae* wherein it first urged that the statute in terms was to be construed as I have stated above and much of the reasoning I have employed was there adduced in support of its view. Then it undermined its own opinion by urging that it had freed the defendants of liability by adopting its Rule X-16A-3(b) requiring a partner to file a report to it "only as to that amount of such equity security which represents his proportionate interest in the partnership," and that the defendants were justified in assuming the Commission to hold the other partners not liable here. The court in the *Rattner* case rejected this argument, saying: "The Commission may exempt 'transactions'; but it cannot reduce the

liability imposed by section 16(b)." *Rattner v. Lehman*, *supra*, 2 Cir., 193 F. 2d 564, 566. That the Commission had its doubts at least as to the policy of its rule is shown by the following statement in its *Rattner* brief: "For reasons summarized below the Commission now has substantial doubt as to whether Rule X-16A-3 fully effectuates the statutory purpose of Section 16. It is therefore currently considering amending the rule to limit the broad exemption now implicit in it."

At any rate the Commission soon (1953) amended its rule to require a partner to report the entire amount of the security owned by the partnership, Rule X-16A-8(g), adopted by Sec. Ex. Act Rel. 4801 (1953), now 17 CFR (1960 Supp.) §240.16a-3(b). Loss, Securities Regulation 585-587 (1955 Supp.). And there the matter now stands, with the Commission at odds with our interpretation.

The matter of the validity of such a Commission regulation is obviously still an open one. We expressed doubt as [fol. 194a] to another rule in *Greene v. Dietz*, 2 Cir., 247 F. 2d 689, which was thereafter held invalid in *Perlman v. Timberlake*, D. C. S. D. N. Y., 172 F. Supp. 246; but the contrary was held in *Continental Oil Co. v. Perlitz*, D. C. S. D. Tex., 176 F. Supp. 219. Seemingly the Commission still relies on its power under the statute. See Timbers, *Management Compensation Plans: SEC Problems*, Proceedings of the Second Annual Institute on Corporate Counsel, April 21, 22, 1960 (Fordham Univ. Press) 28, 37-38; Meeker & Cooney, *The Problem of Definition in Determining Insider Liabilities Under Section 16(b)*, 45 Va. L. Rev. 949, 957 (1959); Cook & Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 612, 632-635 (1953); Loss, Securities Regulation 578 (1951). This is an obvious state of confusion and uncertainty which is unfortunate to the public, the investors, and their traders. I do not believe any inference can be drawn from the failure of Congress to act to correct the *Rattner* decision; that body has lately been interested in other matters more immediately troublesome than that of the regulation of private investments and the S. E. C. obviously has not given it positive leadership. So it would seem to me that at least before

we dispose of this vastly important issue we should ask the S. E. C. for its informed comments.

I should add that I agree with the method of computation, finding a "purchase" under §16(b) and a total profit to the firm of \$98,686.77, which Judge Dawson followed and Judge Medina approves in his opinion. But this computation, upon which we all agree, highlights the anomaly of the ultimate conclusions reached by my brothers. For they are forced to concede that insider profits were made and that there must be restitution to the corporation, but then they differ widely as to how much is to be restored. It seems to me that neither of their results can be justified logically or legally under any principles of the law of [fol. 195a] partnership with which I am familiar. I submit that if there were insider profits (as their concession shows) then the partnership and the individual partners must be held liable to return these profits in full to TideWater. And that should be our decision. The final anomaly in our exceptional treatment of this case is the denial of all interest for the use of the sums found due the corporation, contrary to our uniform practice in other cases. *Magida v. Continental Can Co.*, 2 Cir., 231 F. 2d 843, 848, certiorari denied *Continental Can Co. v. Magida*, 351 U. S. 972; *Blau v. Mission Corp.*, 2 Cir., 212 F. 2d 77, 82, certiorari denied *Mission Corp. v. Blau*, 347 U. S. 1016; *Park & Tilford v. Schulte*, 2 Cir., 160 F. 2d 984, 988, 989, certiorari denied *Schulte v. Park & Tilford*, 332 U. S. 761. If there are special equities here, they have not been stated.

I would reverse and remand for the entry of a judgment returning to the TideWater corporation all the profits made from the transaction by the defendants, together with interest and costs.

[fol. 196a]

IN UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

Present: Hon. Thomas W. Swan, Hon. Charles E. Clark,  
Hon. Harold R. Medina, Circuit Judges.

ISADORE BLAU, a Stockholder of Tide Water Associated  
Oil Company, Plaintiff-Appellant,

v.

ROBERT LEHMAN, et al., Defendants-Appellees,  
and

JOSEPH A. THOMAS, Defendant-Appellant,  
TIDEWATER ASSOCIATED OIL COMPANY, Defendant.

JUDGMENT—December 20, 1960

Appeal from the United States District Court for the  
Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is Affirmed.

A. Daniel Fusaro, Clerk.

[fol. 197a]

[File endorsement omitted]

[fol. 204a]

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 25846

ISADORE BLAU,

v.

ROBERT LEHMAN, et al.

NOTICE OF MOTION—Filed February 21, 1961

To:

Morris J. Levy, Esq., 261 Broadway, New York 7, New York.

Simpson Thacher & Bartlett, 120 Broadway, New York 5, New York.

Please take notice that the attached motion of the Securities and Exchange Commission for leave to participate *amicus curiae* and to file a petition for rehearing is returnable on Monday, January 9, 1961 at the United States Court House, Foley Square, New York, New York at 10:30 A.M. or as soon thereafter as counsel can be heard.

Walter P. North, General Counsel, Securities and Exchange Commission, Washington 25, D.C.

January 3, 1961

[fol. 205a]

MOTION OF THE SECURITIES AND EXCHANGE COMMISSION FOR  
LEAVE TO PARTICIPATE *AMICUS CURIAE* AND TO FILE A  
PETITION FOR REHEARING—Filed February 21, 1961

To the Honorable Judges of Said Court:

The Securities and Exchange Commission respectfully moves this Court for leave to participate *amicus curiae* and to file the attached petition for rehearing for reasons stated in the attached petition.

Walter P. North, General Counsel, Securities and Exchange Commission, Washington 5, D. C.

January 3, 1961

[fol. 206a]

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 25846

ISADORE BLAU,

v.

ROBERT LEHMAN, et al.

On Appeal From a Judgment of the United States District  
Court for the Southern District of New York

PETITION OF THE SECURITIES AND EXCHANGE COMMISSION,  
AMICUS CURIAE, FOR REHEARING—Filed February 21, 1961

To the Honorable Judges of This Court:

The Securities and Exchange Commission respectfully petitions this Court for rehearing, perhaps en banc, of its decision herein dated December 20, 1960, so as to permit the Commission to urge that this Court in its decision should overrule its earlier interpretation of Section 16(b) of the Securities Exchange Act of 1934 as enunciated in *Rattner v. Lehman*, 197 F. 2d 564.

1. The decision of this Court involves an important interpretation of Section 16(b) of the Securities Exchange Act of 1934, and, as indicated in the dissenting opinion, the views of the Commission might be helpful to this Court.

2. Although we were aware of the pendency of these proceedings prior to the issuance of this Court's decision, it appeared to us that the case would turn on factual disputes rather than on a legal interpretation of the statute and for that reason the Commission did not request permission to appear *amicus curiae* at an earlier date.

[fol. 207a] Should rehearing be granted the Commission undertakes to file a memorandum of its views within ten days of the granting of the petition.

Respectfully submitted,

Walter P. North, General Counsel, Securities and  
Exchange Commission, Washington 25, D.C.

January 3, 1961



Motion for leave to participate as amicus curiae and to file petition for rehearing is denied.

TWS, HRM.

I dissent and vote for a rehearing in banc.

C.E.C.

[File endorsement omitted]

[fol. 209a]

IN UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 25846

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company, Plaintiff-Appellant-Appellee,

—against—

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of LEHMAN BROTHERS, Defendants-Appellees,

JOSEPH A. THOMAS, Defendant-Appellee-Appellant,

and

TIDE WATER ASSOCIATED OIL COMPANY, Defendant-Appellee.

**AFFIDAVIT ON BEHALF OF ISADORE BLAU, PLAINTIFF-APPELLANT APPELLEE, IN SUPPORT OF THE MOTION BY THE SECURITIES EXCHANGE COMMISSION FOR LEAVE TO APPEAR AS AMICUS CURIAE AND FOR LEAVE TO FILE PETITION FOR REHEARING—Filed February 21, 1961**

State of New York,  
County of New York, ss.:

Morris J. Levy, being duly sworn, deposes and says:

I am the attorney for Isadore Blau, Plaintiff-Appellant-Appellee herein, and make this affidavit in support of the motion by the Securities Exchange Commission for leave to appear as *Amicus Curiae* and for leave to file its Petition for a Re-Hearing *en banc*.

Although the Securities and Exchange Commission has been ordained by the Congress to administer the Securities [fol. 210a] Exchange Act of 1934, this Court was not afforded the opportunity of being advised upon the argument of this Appeal concerning the Commission's views with respect to important legal problems within its particular field of expertise.

For reasons best known to itself, the Commission did not participate in the arguments before this Court.

In view of the importance to the general public of the legal issues here involved and the adjudication thereof by this Court, the Commission has now asked for leave to appear as *amicus curiae* and for leave to file its Petition for a re-hearing before this Court "*perhaps en banc*".

Since it has been held that an Administrator's views with respect to the Statute it administers is "entitled to great weight"—I respectfully urge this Court to grant its application for a re-hearing so that all the aspects of the important legal issues may be explored.

Morris J. Levy

Sworn to before me this 9th day of January, 1961.

Marvin Zuckerberg, Notary Public, State of New York  
[balance illegible].

[fol. 211a] [File endorsement omitted]

[fol. 220a]

IN UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

No. 51—October Term, 1960

(Motion submitted January 9, 1961)

Decided February 21, 1961)

Docket No. 25846

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company, Plaintiff-Appellant-Appellee,

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of LEHMAN BROTHERS, Defendants-Appellees,

JOSEPH A. THOMAS, Defendant-Appellee-Appellant,

and

TIDE WATER ASSOCIATED OIL COMPANY, Defendant-Appellee.

[fol. 221a]

*Motion for Leave to Participate as Amicus Curiae and to File Petition for Rehearing*

Walter P. North, General Counsel, Securities & Exchange Commission, Washington, D. C., for Securities & Exchange Commission.

Motion for leave to participate as *amicus curiae* and to file petition for rehearing is denied.

T. W. S., H. R. M., *U.S.C.JJ.*

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I dissent and vote for a rehearing *in banc*.

C. E. C., *U.S.C.J.*

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*Petition for Rehearing in Banc*

The active judges, having voted to deny the petition for rehearing *in banc*, except Judges Clark and Smith who dissent and vote to grant the petition, the petition is denied.

J. Edward Lumbard, *Chief Judge*.

February 21, 1961

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CLARK, *Circuit Judge* (dissenting):

The court's refusal by majority vote to take any steps to abate the confusion resulting from the decision by our senior panel has striking connotations beyond those affecting the central issue on the merits, important as that is. Chief among these added consequences is the precedent—[fol. 222a] the first time in our history—of refusing the assistance of the Securities and Exchange Commission, here proffered as a result of the need therefor expressed by the writer as a member of the court. This re-enforces the harsh refusal of the original panel majority. Under the peculiar circumstances here present making S. E. C. advice more relevant than usual, I should have thought that we would have accepted the offer with alacrity, whatever our eventual views as to the merits; and I am chagrined that an individual judge's "right to know" is thus so severely circumscribed. Some instances where such help has been gladly received, as well as others where its absence is deplored, are noted in *Greene v. Dietz*, 2 Cir., 247 F. 2d 689, 696. Even in the case which is being treated as controlling here, *Rattner v. Lehman*, 2 Cir., 193 F. 2d 564, the court, although rejecting the Commission's advice in part, nevertheless paid it the compliment of devoting a major part of its discussion

to the Commission's presentation. I submit with deference that the correct approach here was that followed in *Greene v. Dietz*, *supra*, 2 Cir., 247 F. 2d 689, 697:

"Although neither appellant nor appellee sought a rehearing in this case, the Securities and Exchange Commission timely filed an application with us seeking our permission to file a petition, *amicus curiae*, for a rehearing. *We readily granted such permission.* [Emphasis added.] The Commission represents to us that our opinion of June 7, 1957 should be clarified . . . . We are grateful to the Commission for the interest it has shown, and we order that the brief offered by it in support of its petition be filed and made a part of the records in the case."

In my original dissent I pointed out why S. E. C. advice seemed particularly desirable here. In addition to the [fol. 223a] expertise which the Commission and its staff must necessarily have acquired over the years in an area particularly committed to its care, there were the special considerations that the Commission has long required reporting by trading partnerships of all insider short-swing profits acquired by them and hence must know the dimensions of the problem and further that the Commission had made changes in its regulations signifying lack of confidence in the *Rattner* rule, the rationale for which changes surely would be enlightening. Now the reasons presently stated by the Commission for its appearance intensify this need for enlightenment. For it requests granting of its petition for rehearing "so as to permit the Commission to urge that this Court in its decision should overrule its earlier interpretation of Section 16(b) of the Securities Exchange Act of 1934 as enunciated in *Rattner v. Lehman*, 193 F. 2d 564." An explanation of its reasons for coming to its present conclusion could hardly fail to be instructive.

My brothers offer no explanation of their decision, and the grounds therefor can only be inferred. But since a decision on the merits is avoided in a situation where the need therefor is great, it is probably a fair inference that procedural barriers were thought to exist. It is believed,

however, that actually none such are discoverable. As concerns the S. E. C. it has followed the exact procedure found acceptable in *Greene v. Dietz, supra*, 2 Cir., 247 F. 2d 689. The Commission states that it refrained from seeking to enter earlier because of its conclusion that the case here would turn on issues of fact—a very reasonable deduction, since *Rattner* had assumed to settle the law. Undoubtedly, too, rejection of its views in the *Rattner* case obviously suggested caution until it received something approaching an invitation from members of the court. And if we are at all realistic we must recognize that changes in Commission [fol. 224a] personnel may well have resulted in a new and different policy.

The S. E. C. application is now supported by the plaintiff. Here, too, there seems to be some implication that he has been dilatory. But I do not see how this can be sustained. Notwithstanding the two long holiday week ends immediately after our decision he moved with due promptness, and within the 15 days stated in our Local Rule 25(a), for certification of the case to the Supreme Court. While this may not have been good tactics in view of our customary unwillingness to certify, yet it does show his desire and speedy attempt to secure some form of review. Upon denial of his motion by a divided court and the intervening application by the S. E. C., he promptly filed his motion and affidavit supporting the request of the S. E. C. to be heard *in banc*. Thus at no time has our decision become final, and it will not become so until the filing of the present order. Obviously there has been no prejudice to anyone by any supposed delay. Moreover, it has been our uniform practice to grant additional time for presentation of petitions for rehearing, since we have preferred to terminate the process of adjudication by decisions on the merits rather than by application of some newly fashioned time barriers. Indeed I can recall no case where we have ever rejected a meritorious petition for rehearing on the ground that it was untimely. The fashioning of procedural rules *ad hoc* to avoid decision on the merits is always to be deplored. Clark, Code Pleading 71 (2d Ed. 1947).

I am bound to add that I consider all these implications of procedural barriers irrelevant; for even if these suitors



could have been considered in default as private claimants, yet we must not overlook the fiduciary character in which they here appear. Both the Commission and the plaintiff are trustees of the public interest; their private interest is either nominal or, in the case of the Commission, non-[fol. 225a] existent. At best they do but remind us of our own public responsibility. In such case I doubt if a few days' delay in the holiday season can properly be seized upon by us as justifying our inaction in the public regard. Consideration on the merits, far from according succor to the laggard, would be but a proper response to a judicial obligation to do justice to all, however incompletely represented.

But, whatever the reasons to be assigned for the result, it leaves this important area of the law almost ludicrously uncertain. What now is the present force to be assigned to *Rattner*? Although it is assumed to compel the present decision, yet quite significantly not a single word in its defense has been uttered by any of the eight judges here engaged. My own criticisms uttered in my dissent have remained unanswered and have now, as is apparent, the support of the S. E. C. But even further, Judge Medina, in writing the main opinion and though he held himself bound by the decision, uttered as strong a criticism of its results as has appeared, in supporting the fundamentally inconsistent ruling that the partner-director must give up something representing his share of insider profits to the corporation. And in this Judge Swan concurred, although agreeing neither on the principle nor on the actual amount of the recovery. It is indeed ironical that so disfavored a precedent<sup>1</sup> nevertheless has apparent power to control even to the extent of ruling out proper restrictions or exceptions there at least implied with respect to a director who gives actual investment advice.

The most serious vice of the *Rattner* decision is the unfair discrimination it builds into an important remedial

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<sup>1</sup> It has remained uncited elsewhere except for one purely incidental reference in *Lehman v. Civil Aeronautics Board*, D. C. Cir., 209 F. 2d 289, 294, n. 9, certiorari denied 347 U. S. 916.

statute—a discrimination substantially eliminating the great Wall Street trading firms from the statute's operation. [fol. 226a] So great is the unfairness of the result that, notwithstanding its remedial nature, the statute, it would appear, should not stand unless its judicially discovered defects can be corrected. But before that conclusion is finally reached let us hope that the S. E. C. may discover some tribunal prepared and willing to listen to its arguments.

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SMITH, *Circuit Judge*:

I join in the dissent of Clark, *C.J.*

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[fol. 227a]

IN UNITED STATES COURT OF APPEALS  
SECOND CIRCUIT

Present: Hon. Thomas W. Swan, Hon. Charles E. Clark,  
Hon. Harold R. Medina, Circuit Judges.

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ISADORE BLAU, a Stockholder of Tide Water Associated  
Oil Company, Plaintiff-Appellant,

v.

ROBERT LEHMAN, et al., Defendants-Appellees,  
and

JOHN A. THOMAS, Defendant-Appellant,  
TIDEWATER ASSOCIATED OIL COMPANY, Defendant.

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ORDER DENYING MOTION OF THE SECURITIES AND EXCHANGE  
COMMISSION FOR LEAVE TO PARTICIPATE AS AMICUS CURIAE  
AND TO FILE A PETITION FOR REHEARING—February 21,  
1961

A motion having been made herein by counsel for the Securities and Exchange Commission for leave to participate as amicus curiae and to file a petition for rehearing,

Upon consideration thereof, it is

Ordered that said motion be and it hereby is denied.

[fol. 228a] [File endorsement omitted]

[fol. 229a]

IN UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Present: Hon. J. Edward Lumbard, Chief Judge, Hon. Charles E. Clark, Hon. Sterry R. Waterman, Hon. Leonard P. Moore, Hon. Henry J. Friendly, Hon. J. Joseph Smith, Circuit Judges.

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company, Plaintiff-Appellant-Appellee,

v.

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of LEHMAN BROTHERS, Defendants-Appellees,

JOSEPH A. THOMAS, Defendant-Appellee-Appellant,

and

TIDE WATER ASSOCIATED OIL COMPANY, Defendant-Appellee.

ORDER DENYING PETITION FOR REHEARING IN BANC  
—February 21, 1961

A petition for rehearing in banc having been taken under advisement,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

[fol. 230a] [File endorsement omitted]

[fol. 231a] Clerk's Certificate to foregoing transcript  
(omitted in printing).

[fol. 232a]

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SUPREME COURT OF THE UNITED STATES

No. 810, October Term, 1960

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ISADORE BLAU, etc., Petitioner,

vs.

ROBERT LEHMAN, et al.

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ORDER ALLOWING CERTIORARI—April 24, 1961

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Office Supreme Court, U.S.

FILED

MAR 14 1961

WILLIAM E. BROWNING, Clerk

IN THE  
**Supreme Court of the United States**

October Term, ~~1960~~ 1961

No. ~~100-100000~~ 66

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

*Petitioner,*

*against*

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMER-SLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of LEHMAN BROTHERS, JOSEPH A. THOMAS, and TIDE WATER ASSOCIATED OIL COMPANY,

*Respondents.*

**Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit.**

MORRIS J. LEVY,  
*Counsel for Petitioner, Isadore Blau,*  
261 Broadway,  
New York 7, N. Y.

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IN THE  
**Supreme Court of the United States**

October Term, 1960.

No.

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ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

*Petitioner,*

*against*

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of Lehman Brothers, JOSEPH A. THOMAS and TIDE WATER ASSOCIATED OIL COMPANY,

*Respondents.*

---

**PETITION FOR WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS FOR THE  
SECOND CIRCUIT.**

To The Honorable, The Chief Justice and Associate Justices of The Supreme Court of The United States.

Your petitioner, Isadore Blau, a stockholder of Tide Water Associated Oil Company, acting on behalf of himself and the other stockholders of said corporation, respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, rendered December 20, 1960 (R. 196a\*, *infra*, p. 33a), which affirmed (by divided Court) the judgment of the United States District Court for the Southern District of New York (R. 158a-159a) (a) dismissing the complaint as against, respondents, Lehman Brothers, (b) limiting the amount of recovery as against respondent, Joseph A. Thomas, to only his proportionate share of partnership interest in Lehman Brothers, and (3) denying any interest on the recovery.

### Opinions Below.

The opinion of the District Court (R. 149a-157a) is reported in 173 F. Supp. 590. The majority and dissenting opinions of the Court of Appeals (R. 174a-195a, 220a-226a, *infra*, pp. 1a-29a), which affirmed the judgment of the District Court and denied petitioner's motion for a rehearing, have not yet been reported.

### Jurisdiction.

The judgment of the Court of Appeals (R. 196a; *infra*, p. 32a) was entered on December 20, 1960.

By order dated February 21, 1961, the Court of Appeals sitting *in Banc* (two judges dissenting) denied petitioner's motion for rehearing.

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\* References are to pages of Joint Appendix filed with the United States Court of Appeals for the Second Circuit and proceedings had in that Court.

Jurisdiction is conferred upon this Court by 28 U. S. C., Section 1254(1).

### Questions Presented for Review.

1. Under Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sect. 78p(b), where one of the members of a co-partnership firm is a director of a corporation having equity securities listed upon a National Securities Exchange, is the co-partnership liable to such corporation for all "short-swing" profits realized by the firm from its purchases and sales of the corporation's equity securities within a period of less than six months?

2. Under Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sect. 78p(b), where one of the members of a co-partnership firm is a director of a corporation having equity securities listed upon a National Securities Exchange, to what extent is such *partner-director* liable to the corporation for "short-swing" profits realized by his co-partnership firm as a result of its purchases and sales of the corporation's equity securities within a period of less than six months.

3. Under Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sect. 78p(b), when a corporation, having equity securities listed upon a National Securities Exchange, is granted a judgment against its director for the recovery of "short-swing" profits realized by him as a result of the purchases and sales of the corporation's equity securities within a period of less than six months, is the corporation entitled to recover interest upon such profits from the date they were realized and recoverable under the statute?

### **Statute and Regulation Involved.**

Pertinent provisions of the Securities Exchange Act of 1934, Sections 16a and 16(b), 15 U. S. C. A., Sects. 78p(a) and 78p(b), p. 419, are set forth in Appendix, *infra*, pp. 30a-31a. Pertinent provisions of the Securities and Exchange Commission Rule X-16A-3(b), as amended October 4, 1952, 17 CFR 240.16a-3(b), p. 149 Cum. Supp., are set forth in Appendix, *infra*, p. 31a.

### **Statement of Facts.**

The action was brought by petitioner, Blau, as a stockholder of Tide Water Associated Oil Company (hereinafter referred to as "Tide Water"), pursuant to Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sect. 78p(b), to recover the profits realized by respondent, Lehman Brothers, from its purchases and sales of Tide Water's listed stock within a period of less than six months.

The basis for jurisdiction of the United States District Court for the Southern District of New York, where the action was instituted, is Section 27 of the Securities Exchange Act of 1934, 15 U. S. C. A., Sect. 78aa.

Respondent, Lehman Brothers, a co-partnership, is in the investment banking business, a member of various stock exchanges, and also trades in securities for its own account (R. 32a-33a).

Respondent, Joseph A. Thomas, a partner of Lehman Brothers, became a director of Tide Water on August 5, 1954, after another partner of Lehman Brothers who was resigning from the Tide Water Board had spoken to the latter's president and had recommended Mr. Thomas as his replacement (R. 38a, 64a).

During the time respondent, Thomas, was a director of Tide Water, Lehman Brothers participated in a \$50 million bond underwriting issue for Tide Water and Mr. Thomas was assigned by Lehman Brothers to represent its interests with respect to such financing (R. 42a, 76a-77a). Prior to that time, and while another partner of Lehman Brothers was a director of Tide Water, Lehman Brothers had on several occasions performed similar services for Tide Water (R. 17a).

After respondent, Thomas, had become a director of Tide Water, several of his partners at Lehman Brothers asked for his opinion concerning Tide Water's management and policies. Mr. Thomas expressed his opinions to them "freely" and "suggested from time to time that I thought Tide Water under the new management was an attractive investment" (R. 54a-56a).

Between October 8, 1954 and November 15, 1954, Lehman Brothers purchased for its own account 50,000 shares of Tide Water common stock which it proposed to convert into Preferred stock and thereafter sell to institutional investors (R. 43a-44a, 49a-50a).

Prior to the date when William J. Hammerslough, a partner of Lehman Brothers, authorized his firm's purchases of the Tide Water common stock, he discussed the advisability of such purchases with some of his partners. Mr. Hammerslough testified that respondent, "Thomas spoke very highly of the management and prospects of Tide Water Oil Company" and "thought very highly of it"; as a result of such discussions, they felt "that this preferred stock into which the common was going to be exchanged . . . would be a very, very safe, good investment, and would be attractive once it was issued, to institutional investors throughout the country" (R. 69a, 71a).



On December 8, 1954, Lehman Brothers converted its 50,000 shares of Tide Water common stock into 50,000 shares of preferred stock (R. 86a). The District Court held that such acquisition of Tide Water Preferred stock by Lehman Brothers constituted a "purchase" thereof within the meaning and intent of Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sect. 78p(b) (R. 156a).

Within a period of less than six months from its aforesaid "purchase" of Tide Water preferred stock, Lehman Brothers sold 50,000 shares thereof (R. 87a).

The District Court found, after trial without a jury, that Lehman Brothers had realized "short-swing" profits aggregating the sum of \$98,686.77 from its aforesaid transactions in the Tide Water Preferred stock (R. 156a).

Petitioner contended that respondents, Lehman Brothers, and its partner-director, Thomas, were jointly and severally liable to Tide Water under the statute for all the "short-swing" profits realized by the partnership firm.

The District Court dismissed the complaint as against respondent, Lehman Brothers, and entered judgment against respondent, Thomas, in the sum of only \$3,893.41 which represented the latter's proportionate partnership share of the total "short-swing" profits realized by Lehman Brothers as aforesaid. The Court also refused to allow any interest upon the recovery (R. 158a-159a). The Court of Appeals affirmed.

### **Reasons Relied on For Granting the Writ.**

1. The Court of Appeals for the Second Circuit has decided an important question of federal law which has not been, but should be settled by this Court. The interpretation of the federal statute by the Court of Appeals finds

no sanction in the statute and is in conflict with the stated Congressional purpose and intent which prompted its enactment.

2. The Court of Appeals for the Second Circuit has refused to accord any recognition to a Regulation promulgated by the Securities and Exchange Commission with respect to a statute involving the Securities Exchange Act of 1934. As a result of the Court's decision, the validity of such Regulation and the Commission's power to promulgate it is in doubt and can no longer be used as a guide to conduct under the statute.

3. The Court of Appeals for the Second Circuit has departed from its usual and accepted course in identical cases by denying an award of interest upon the recovery of "short-swing" profits under Section 16(b) of the Securities Exchange Act of 1934. As a result of its decision the Court of Appeals has created a condition of uncertainty and confusion respecting the interpretation and applicability of this phase of the statute.

## **ARGUMENT.**

### **I.**

The Court below has decided an important question of Federal law which has not been, but should be, settled by this Court.

The stated Congressional purpose for the enactment of Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., 78p(b), was "preventing the unfair use of information which may have been obtained by such beneficial owner, director or officer by reason of his relationship to the issuer."

In attempting to foreclose the avenue of proven abuses to such "insiders" having access to corporate information not available to the general investing public, the method adopted by Congress to accomplish this result was to make the "insider" disgorge all the profits realized by him from his "short-swing" transactions in the issuer's securities "irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months."

In specifying three categories of those who clearly have access to inside corporate information, the Legislature at no time evinced any intention of limiting the statutory application to only those literally designated therein while completely exonerating others who demonstrably fall within its inhibitory ambit and similarly have access to and actually make use of inside information for their own selfish interests.

In construing Section 16(b) of the Act, the Courts have uniformly held the statute to be "broadly remedial" and its purpose "to strike down any means by which insiders, because of their special knowledge of the affairs of the corporation or the plans of its board of directors, might realize for themselves a 'short-swing' profit, which would be denied the other stockholders or investing public, not enjoying such inside information."

The close relationship between respondent, Thomas, and his partners, respondent, Lehman Brothers, was such as to constitute them collectively as "insiders" within the intent and meaning of the statute. The respondent, Lehman Brothers, acting as an entity, and having its firm

<sup>1</sup> *Smolowe v. Delendo Corp.*, 2 C. A., 136 F. 2d 231, 239.

<sup>2</sup> *Kogan v. Schulte*, 61 F. Supp. 604, 608; *aff'd sub. nom.*; *Park & Tilford, Inc., v. Schulte*, 2 C. A., 160 F. 2d 984.

interests represented upon Tide Water's Board by Mr. Thomas, had the same influence and access to confidential information as its partner, Mr. Thomas, the director of Tide Water.

Sound public policy for the enforcement of Section 16(b) of the Securities Exchange Act of 1934 requires this statute to be construed "so as to carry out in particular cases the generally expressed legislative policy."

Unless the statute is so construed as to hold both the partnership and its partner-director liable for all "short-swing" profits realized by the firm, the stated Congressional purpose for its enactment will be defeated and the doors will again be left wide open to indiscriminate stock manipulations contrary to the public interests.

Judge Medina, writing for the majority in the Court below recognized that "There is only one way to prevent stock manipulation by insiders to whom confidential information is available, and that is to squeeze every possible penny of profit out of such transactions." Although he further stated that one way to accomplish the Congressional purpose inherent in the statute "was to construe Section 16(b) to include the partnership because of the unity of the partnership relationship and the fact that one of the partners is a director",—he felt bound by the prior decision of the Court which had ruled otherwise in *Rattner v. Lehman*, 2 C. A., 193 F. 2d 564 (R. 183a, *infra*, p. 10a).

In that case the Court had affirmed the judgment of the District Court dismissing the complaint as against the partnership which had realized the "short-swing" profits, and awarding judgment against the partner-director for only his proportionate share of the partnership profits.

<sup>3</sup> *S. E. C. v. Joiner Corp.*, 320 U. S. 344, 350, 351, 64 S. Ct. 120, 123, 88 L. Ed. 88.

The rationale for the Court's decision in the *Rattner* case was predicated upon the following grounds:

First was its reliance upon a literal reading of the statute that Section 16(b) "contains no provision requiring the partners of a director to account for profits realized by them."

However, as Judge Clark pointed out in his dissenting opinion below,—“But any reading (of the statute), literal or otherwise, can hardly avoid the legal meaning of ‘owner’ or eliminate the basic principles of partnership” (R. 189a, *infra*, p. 16a).

Under the basic principles of partnership law, each partner is “co-owner” of all property purchased with the partnership funds and has an equal right with his other partners to possession therein. Respondent, Thomas, therefore, was co-owner of the Tide Water stock purchased by his firm as well as of the profits realized from his firm's subsequent sales thereof.

Thus, unless the statute were construed to mean that Congress expressly intended to exclude “co-owner” because it only expressly refers to “owner” therein, the majority opinion of the Court below, which predicated its decision upon the *Rattner* case, must be overruled.

The second ground for the *Rattner* decision was based upon the elimination from the statute as finally enacted of those provisions in the earlier drafts of Section 16 which had imposed the statutory liability upon persons acting upon confidential information disclosed to them by a director or officer of the issuer involved.

The omission from the statute of such provision was prompted “presumably because the burden of proof made enforcement unfeasible,” although it was conceded at

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\* *Smolowe v. Delendo Corp.*, 2 C. A., *supra*, p. 236.

the Congressional Hearings that such provision would greatly aid in accomplishing the purposes of the section.<sup>5</sup>

Although the legislative history and the statute itself indicates that Congress eliminated a "subjective standard of proof, requiring a showing of an actual unfair use of inside information,"<sup>6</sup> the decision of the *Rattner* case, which was followed by the Court below, appears to make such "subjective proof" the criterion for any recovery against the partnership entity.

In his dissenting opinion in the Court below, Judge Clark found that "The most serious vice in the *Rattner* decision is the unfair discrimination it builds into an important remedial statute—a discrimination substantially eliminating the great Wall Street trading firms from the statute's operation." Judge Clark further pointed out that the majority opinion of the Court now "leaves this important area of the law almost ludicrously uncertain.

Unless this uncertainty is settled by this Court, the administration and enforcement of the statute will be breached to such an extent that its continued existence will become meaningless.

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<sup>5</sup> See Hearings before Senate Committee on Banking and Currency on S. Res. 84, 72d Cong., 2d Sess., pp. 6555 *et seq.*; Hearings before the House Committee on Interstate and Foreign Commerce on H. Res. 7852 and 8720, 72nd Cong., 2d Sess., pp. 135 *et seq.*

<sup>6</sup> See *Smolowe v. Delendo Corp.*, *supra*, p. 236; *Gratz v. Claughton*, 2 C. A., 187 F. 2d 46, 50, cert. denied 341 U. S. 920.



## II.


The Court below refused to accord any consideration to the pertinent regulation promulgated by the Securities and Exchange Commission and refused to follow the Commission's interpretation thereof.

In the *Rattner* case, the Court found "further support" for limiting the recovery as against the partner-director by citing the then existing Securities and Exchange Rule X-16A-3(b), which permitted a partner, who was a director of an issuer covered by the statute, to report "only as to that amount of such equity security which represents his proportionate interest in the partnership." The Court held that in view of the Commission Rule aforesaid, the partner-director's liability should be limited to the extent that he was required to report his partnership transactions under the statute.

The Commission, appearing as *amicus curiae* in support of the Court's ultimate decision in the *Rattner* case, urged that under its Rule aforesaid the partner-director "would be fully warranted in construing the rule as defining the maximum scope of (his) liability to surrender profits." In its Brief the Commission further stated, however, that "it now has substantial doubts as to whether Rule X-16A-3 fully effectuates the statutory purpose of Section 16(b)."

Following the *Rattner* decision, the Commission amended Rule X-16A-3(b), 17 CFR 240.16a-3(b) (*infra*, p. 31a), so as to require a partner, who is a director of an issuer covered by the statute, to "include in his report the entire amount of such equity security owned by the partnership."

In view of such amendment of the Commission Rule, there no longer exists any valid reason for limiting the



liability of the partner-director. Indeed, the construction given to the Commission Rule by the Court in the *Rattner* case now requires that the partner-director be held liable for the "entire amount" of the profits realized by the partnership firm.

The Court below, however, failed to take the aforesaid amended Rule into consideration but insisted upon limiting the recovery against respondent, Thomas, to only his proportionate share of his firm's profits.

Following the decision by the Court below, the Commission duly moved for leave to intervene as *amicus curiae* and requested a rehearing urging the Court to "overrule its earlier interpretation of Section 16(b) of the Securities Exchange Act of 1934." The Court denied the Commission's application (R. 204a-207a).

It thus appears that the Commission and the Court below are at odds with respect to the effect and validity of the Commission's Rule.

Judge Clark in his dissenting opinion aptly pointed out that "This is an obvious state of confusion and uncertainty which is unfortunate to the public, investors, and their traders" (R. 194a, *infra*, p. 21a).

Only this Court can close the gap and settle the controversy.

## III.

The decision by the Court below denying interest upon the recovery under the statute is in conflict with its prior decisions on that point.

The purpose of Section 16(b) of the Securities Exchange Act of 1934 is "to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director or stockholder and the faithful performance of his duty." *Smolowe v. Delendo Corp.*, 2 C. A., *supra*, p. 239.

Despite the fact that Judge Medina, writing for the majority in the Court below, fully recognized that the purpose of the statute "is to squeeze every penny of profit out of such (short-swing) transactions"—no interest was allowed by the Court upon the recovery against respondent, Thomas.

In thus refusing to grant interest upon the short-swing profits recovered, the Court in effect *reduced* such recovery by an amount equal to the interest earned by respondents' use of the money from the date the profits were recoverable.

Although the statute is silent with respect to interest, the Court below has on all prior occasions awarded such interest as an incident of the recovery.

In his dissenting opinion Judge Clark recognized that "The final anomaly in our exceptional treatment of this case is the denial of all interest for the use of the sums found due to the corporation, contrary to our uniform practice in other cases."

The obvious confusion arising from the decision of the Court below with respect to the awarding of interest upon any recovery under the statute can only be settled by this Court.

### **CONCLUSION.**

**For the foregoing reasons, this petition for a writ of certiorari should be granted.**

Respectfully submitted,

**MORRIS J. LEVY,**  
Counsel for Petitioner, Isadore Blau,  
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New York 7, New York.

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## APPENDIX.

1a

### United States Court of Appeals

FOR THE SECOND CIRCUIT

No. 51—October Term, 1960.

(Argued November 1, 1960 Decided December 20, 1960.)

Docket No. 25846

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ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

*Plaintiff-Appellant-Appellee,*

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of LEHMAN BROTHERS,

*Defendants-Appellees,*

JOSEPH A. THOMAS,

*Defendant-Appellee-Appellant,*

and

TIDE WATER ASSOCIATED OIL COMPANY,

*Defendant-Appellee.*

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**Opinion.****Before:****SWAN, CLARK and MEDINA,***Circuit Judges.*

Cross-appeals from a judgment of the United States District Court for the Southern District of New York. Archie O. Dawson, *Judge*.

In an action by a stockholder of Tide Water Associated Oil Company for recovery of short swing profits against Joseph A. Thomas, a director, and against Lehman Brothers, a partnership composed of Joseph A. Thomas and others, based upon Section 16(b) of the Securities Exchange Act of 1934, the complaint was dismissed as against Lehman Brothers and a recovery allowed against Joseph A. Thomas for \$3,893.41, the share of the firm profits from the purchase and sale of Tide Water Associated Oil Company stock found to have been "realized," although "waived" and not received by Thomas, but without interest. Cross-appeals by plaintiff and by Joseph A. Thomas. Opinion below reported in 173 F. Supp. 590. Affirmed.

**MORRIS J. LEVY**, New York, N. Y., *for plaintiff-appellant-appellee*.

**CYRUS R. VANCE**, New York, N. Y. (Robert S. Carlson and Simpson Thacher & Bartlett, New York, N. Y., on the brief), *for defendants-appellees (other than Tide Water Associated Oil Company) and Joseph A. Thomas, defendant-appellee-appellant*.

*Opinion**MEDINA, Circuit Judge:*

In this action by a stockholder of Tide Water Associated Oil Company brought under Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. Section 78(b),<sup>1</sup> to recover on Tide Water's behalf short swing profits alleged to have been realized by Joseph A. Thomas, a director of Tide Water, and by Lehman Brothers, a partnership of investment bankers and stockbrokers, of which Thomas was a member, the complaint was dismissed as against all the partners other than Thomas, after a trial by the court without a jury, and judgment was entered against him for only \$3,893.41 and costs. The trial judge computed the profits of Lehman Brothers at \$98,686.77 but refused to direct judgment against Thomas for more than the amount which was, despite his claim that he had received no part of the profits, found to have been "realized by him." The method of computing the profits was also matter of dispute

<sup>1</sup> §16(b), 15 U. S. C. §78p(b) reads as follows:

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

*Opinion*

between the parties. Plaintiff and Thomas have filed cross-appeals. The opinion below is reported in 173 F. Supp. 590.

On August 5, 1954 Thomas, then a partner of Lehman Brothers, became a director of Tide Water. Although he succeeded John Hertz, also a partner of Lehman Brothers, Judge Dawson, after a careful and comprehensive review of the testimony, found that "the invitation to join the Tide Water Board was upon the initiative of Tide Water." He also found "there was no evidence that the firm of Lehman Brothers deputed Thomas to represent its interests as director on the board of Tide Water."

On September 17, 1954 public announcement was made in the Wall Street Journal that Tide Water was considering a proposal to allow shareholders to exchange common stock for a new dividend-paying preferred stock; and on October 8, 1954 it was announced in the Wall Street Journal that such a proposal had been approved by the directors. Immediately after this last announcement and on the same day Lehman Brothers, "acting solely on the basis of Tide Water's public announcements and without consulting Thomas with reference thereto," decided to purchase 50,000 shares of Tide Water common stock for the purpose of converting them into the new preferred stock and selling the preferred stock to institutional investors. Thomas had provided no confidential information whatever; and he did not even know the transaction concerning the 50,000 shares of Tide Water stock was under consideration by the Portfolio Committee of Lehman Brothers until the sales slips appeared upon his desk, after the first few thousand shares had been purchased. In response to his inquiry about this he was told that 50,000 shares of Tide Water common were to be bought, converted into preferred and sold. Immediately thereafter Thomas instructed the firm controller "to exclude me from any risk of the purchase or any profit or loss from the subsequent sale and take the necessary steps to carry out my instructions." At a meeting of the

*Opinion*

partners the following Monday he told the other partners that he wanted them to know that he was "not a part of this Tide Water transaction at all," and they agreed. He later filed SEC Form 4 from time to time setting forth all the facts required to be reported, explaining that these were "transactions and holdings of Lehman Brothers a partnership of which I am a member. I have previously waived all interests in a total of 50,000 of these shares."

Between October 8, 1954 and November 15, 1954 Lehman Brothers purchased the 50,000 shares of Tide Water common stock for \$1,330,800. Pursuant to the contemplated plan of recapitalization, Lehman Brothers on December 8, 1954 exchanged its 50,000 shares of common stock for 50,000 shares of a new preferred stock issued by Tide Water. Between December 9, 1954 and March 8, 1955 Lehman Brothers sold its 50,000 shares of preferred stock for \$1,361,186.77. Out of the profits on this series of transactions within a period of six months Thomas received nothing, as his share of the partnership profits was calculated in accordance with his instructions to the firm controller and his oral agreement with his partners to the effect that he was to be cut out of the Tide Water venture.

*The Claim Against Lehman Brothers*

Plaintiff argues that judgment for the full amount of \$98,686.77 should have been rendered against Lehman Brothers. On this phase of the case the contentions of the parties revolve about the decision of this Court in *Rattner v. Lehman*, 2 Cir., 1952, 193 F. 2d 564. While plaintiff does not state in so many words that he asks us to reconsider our rulings in that case, such is the purport of much that is argued in plaintiff's briefs, and I shall assume that the contention is: (1) that the decision in *Rattner* is unsound and the case should be overruled; and (2) that this case is distinguishable on the facts from *Rattner*.

*Opinion*

In that case John D. Hertz, a partner of Lehman Brothers, was a director of Consolidated Vultee Aircraft Corporation. The firm had made short swing profits on the purchase and sale of Consolidated Vultee common stock. Of these profits Hertz received \$806.62 which he turned over to Consolidated Vultee. We refused to hold Lehman Brothers liable for the profits realized by the firm on the ground that Section 16(b) "contains no provision requiring the partners of a director to account for profits realized by them." In answer to the argument that this leaves a loophole in the law Judge Swan, writing for the court, observed that the omission of any provision for such liability "was intentional," as the legislative history of Section 16(b) indicated that a clause in the earlier drafts imposing such liability had been "eliminated from the statute as finally enacted." I feel bound by this ruling, especially since it has been in force for some eight years and the Congress has not seen fit to amend the statute; and Judge Swan and I vote to affirm the judgment in favor of Lehman Brothers on the authority of *Rattner*.

The alleged distinction between this case and *Rattner* on the question of the liability of the partnership is based upon a dictum by Judge Learned Hand in his concurring opinion in *Rattner*, to the effect that he agreed that Section 16(b) did not apply, "but I wish to say nothing as to whether, if a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable." Plaintiff in the case before us argues that there is ample proof that director Thomas was deputed by Lehman Brothers to represent its interests as a director on the board of Tide Water; but the trial judge states that he finds no such evidence in the case.

To begin with, Judge Swan and I do not agree with this dictum, as we must take Section 16(b) as we find it, and we do not see how any sort of deputizing can make the partners of the partnership a "director" within the meaning of



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Section 16(b). But we do not have to decide the question, because the evidence in this case will not support an inference that Lehman Brothers deputized Thomas to represent its interests as director on the board of Tide Water. Doubtless the firm was pleased to have Thomas succeed Hertz as a director, and so was John Schiff, of Kuhn, Loeb & Company, who introduced his friend Thomas to David T. Staples, president of Tide Water who thereafter invited Thomas to become a director. However, there is no evidence of any deputizing or other affirmative action by the firm to cause Thomas to be made a director to protect the interests of the firm or to become its representative.

Reference is made in plaintiff's brief to certain general statements in the findings contained in the opinion in *United States v. Morgan, et al.*, D. C. S. D. N. Y., 1953, 118 F. Supp. 621. These must be understood against the background of the entire history of the investment banking business in the United States that was in one way or another involved in the comprehensive and exceedingly complicated charges of conspiracy to violate the Anti-trust laws. Thus, in reference to a time prior to World War I, when there was a sort of informal working arrangement between Goldman, Sachs & Co. and Lehman Brothers, the opinion states (p. 639):

"With this background, it is easy to see that many of the issuers, especially those whose securities were not well known to the public, leaned heavily upon the sponsorship of the investment banking firms under whose auspices the securities were sold. Issuers invited partners or officers of investment banking firms to serve on their boards of directors, in order to interest investors in their securities. Some of the prospectuses, which in those early days were little more than notices, stated that a partner or officer of a particular investment banking firm would go on the board of directors of the issuer whose securities were being offered to the

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public for sale. Investment bankers sometimes asked to be put on the boards of directors of issuers in order to know how they were managed and to protect the interests of the investors to whom they had sold the issuer's securities. Since the investment bankers sponsored the securities and lent their names to their sale, they felt a certain obligation to the investors to whom they sold the securities to see to it that the issuers did not adopt any policies or engage in any practices which would impair the value of those securities. This was especially important in connection with foreign investors."

But general statements are of little assistance in the decision of particular issues. The fact that Thomas succeeded Hertz as a director of Tide Water, and the circumstance that there were other instances where one partner of Lehman Brothers succeeded another as a director in companies other than Tide Water, in the face of the credible and uncontradicted specific proof of the conversations that led up to the invitation by Staples to Thomas to become a director of Tide Water, are of no probative force whatever. Moreover, I do not think *Lehman, et al. v. Civil Aeronautics Board*, D. C. Cir., 1953, 209 F. 2d 289, cert. denied, 1954, 347 U. S. 916, has any bearing on the case before us.

For the above stated reasons Judge Swan and I find nothing here to distinguish this case from *Rattner*, which requires an affirmance of the judgment dismissing the case as against Lehman Brothers.

*The Claim Against Joseph A. Thomas*

Insofar as plaintiff seeks a judgment against Thomas for the full amount of the profits realized by Lehman Brothers on the Tide Water venture, this was one of the points decided in *Rattner* and Judge Swan and I are content to fol-

*Opinion*

low that ruling. Here again, however, plaintiff claims the present case is distinguishable from *Rattner*. He relies upon a statement in the opinion of Judge Swan that both sides had assumed the stock purchases and sales were made without the knowledge of Hertz, and (193 F. 2d at p. 565) "Whether the result might be different had he caused the firm to make them, we need not now determine." Plaintiff in the case now before us insists that the proofs clearly demonstrate that director Thomas did cause Lehman Brothers to enter into the Tide Water stock venture, despite the findings of the trial judge to the contrary. We see no basis whatever for a decision by us that this finding of the trial judge is clearly erroneous. Indeed, it is the only finding permissible, as the trial judge believed the testimony adduced by Lehman Brothers to prove that director Thomas had revealed no confidential information whatever, and that he did not only did not induce the firm to enter the venture, he had no knowledge that the matter was even under consideration. True he did say to some of his partners and to others as well that he liked the management of Tide Water and thought its general objectives were first-rate, but this is a far cry from the giving of confidential information concerning the forthcoming proposal for recapitalization by the exchange of common stock for a new dividend-paying preferred stock or otherwise causing or inducing the firm to purchase the stock. So, we must reach the same conclusion we did in *Rattner*: whether the result might be different had Thomas caused the firm to enter the Tide Water venture we need not now determine.

Judge Dawson held Thomas for the amount of the profits he would have received had he not attempted to disassociate himself from the 50,000 share transaction and waive his share of the profits. I agree with Judge Dawson that the profits for which he has been held accountable were, in contemplation of law, "realized by him."

*Opinion*

This phase of the case presents an interesting and important question of novel impression that was left open in *Rattner* as Hertz did not resort to any waiver and disclaimer, as did Thomas in the case before us, and he had already voluntarily paid over to the corporation the \$806.62 received by him as his share of the short swing profits of Lehman Brothers on the purchase and sale of Consolidated Vultee stock. This is not a question of New York partnership law, nor a question of Income Tax Law, but rather and solely, as I see it, a question of the interpretation we are to give to a federal statute, Section 16(b).

I hold that when a partnership, one of the partners of which is a director of a corporation, makes short swing profits in speculative buying and selling of the stock of that corporation, the director must be said to have realized the share of the profits to which he would be entitled, irrespective of any waiver or disclaimer by him. Whether or not he actually receives his share of these profits is immaterial; he has "realized" profits and must account for them.

There is only one way to prevent stock manipulation by insiders to whom confidential information is available, and that is to squeeze every possible penny of profit out of such transactions. This has been held to be the clear purpose of Section 16(b), a "broadly remedial statute," *Smolowe v. Delendo Corp.*, 2 Cir., 136 F. 2d 231, 239, cert. denied, 1943, 320 U. S. 751. One way to do this was to construe Section 16(b) to include the partnership because of the unity of the partnership relationship and the fact that one of the partners is a director. But *Rattner* decided otherwise, and that is water over the dam as far as I am concerned. If we now hold that the director himself can escape by the mere devise of a waiver and disclaimer, we shall have opened a breach in the law through which stock-brokers and investment banking houses, those most likely

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to be in a position to profit by the use of confidential information in stock speculation, can pass with impunity.

While no confidential information was improperly used in this case, we must bear in mind that the statute is designed to affect cases where confidential information might be used. Moreover, to permit a waiver and disclaimer to immunize the director would almost certainly lead to wholesale waivers and disclaimers by the various partners who are directors of corporations, with the result that the profits waived by one partner would increase the profits of the others and in the end each would have about the same amount of profits he would have received from such transactions had there been no waiver and disclaimer. When the Congress passed Section 16(b) it was never intended to permit any such merry-go-round as this.<sup>2</sup>

*The Method of Computing the "Profits  
Realized by" Thomas*

The 50,000 shares of common stock of Tide Water were purchased by Lehman Brothers between October 8, 1954 and November 15, 1954; they were converted into the new preferred stock on December 8, 1954; and the 50,000 shares of new preferred stock were sold between December 9, 1954 and March 8, 1955. Thus all of these transactions occurred within the short swing period of six months specified in Section 16(b). If the conversion into the preferred stock constituted a "purchase" under Section 16(b) the profits amounted to \$98,686.77, and the amount of these profits

<sup>2</sup> There is some evidence of this here. During cross examination the defendant Thomas was asked:

"Q. Is it customary for a partner who is a director in a corporation to waive his interests in the short swing profits realized by a corporation?"

He answered:

"A. I think customary is a pretty strong word. But all of us are aware of the existence of 16(b) and you certainly wouldn't want to find yourself in that predicament."

## Opinion

"realized" by Thomas was \$3,893.41, as held by Judge Dawson. But Thomas contends that the conversion was not a "purchase" and that the profit must be computed by subtracting the cost of the shares of common stock from the amount received on the sale of the preferred stock, or \$30,386.71.

We are not, however, computing profits in accordance with what might be the custom of traders and speculators in the stock market. We are construing a federal statute designed to prevent certain persons, including directors and officers, from making short swing profits by "the unfair use of information" available to them because of their confidential relationship to the corporation. The cases present the problem of what is a "purchase" in a great variety of factual combinations. But the underlying principle, as I understand it, is that the transaction is a "purchase" if in any way it lends itself to the accomplishment of what the statute is designed to prevent. The leading case is *Park & Tilford, Inc., v. Schulte*, 2 Cir., 160 F. 2d 984, cert. denied, 1947, 332 U. S. 761. While we held the transaction not to be a "purchase" in *Roberts v. Eaton*, 2 Cir., 1954, 212 F. 2d 82, the same line of reasoning was used.<sup>1</sup> What was done in that case did not lend itself to the furtherance of the prohibited purpose. There is no rule of thumb; nor would it be wise to attempt to formulate such a rule.

Here the acquisition of the preferred stock was in all respects voluntary; Lehman Brothers had the choice of retaining its common stock or exchanging it for preferred stock. The stock of Tide Water was registered on the New York Stock Exchange and was widely held by the public.

<sup>1</sup> See also *Ferraiolo v. Newman*, 6 Cir., 1958, 259 F. 2d 342, 345, cert. denied, 1959, 359 U. S. 927; *Blau v. Mission Corp.*, 2 Cir., 1954, 212 F. 2d 77; *Shaw v. Dreyfus*, 2 Cir., 172 F. 2d 140, cert. denied, 1949, 337 U. S. 907; *Blau v. Lamb*, D. C. S. D. N. Y., 1958, 163 F. Supp. 528, 534; *Blau v. Hodgkinson*, D. C. S. D. N. Y., 1951, 100 F. Supp. 361; *Truncale v. Stumberg*, D. C. S. D. N. Y., 1948, 80 F. Supp. 357.



*Opinion*

When the common was acquired the success of the Lehman Brothers Tide Water venture still depended on future shareholder approval. It was only after approval, the issuance of the preferred stock and the exchange that the profits were realized. The exchange constituted a necessary step to the consummation of the plan. We cannot say that such a situation did not lend itself to manipulation and to the making of short swing profits within the meaning of Section 16(b). We hold the exchange was a "purchase" and that the profits realized were properly computed by Judge Dawson.

*Interest*

Judge Dawson refused to allow interest on the recovery against director Thomas. It is well settled that the allowance of interest in Section 16(b) cases is not mandatory. *Magida v. Continental Can Co.*, 2 Cir., 1956, 231 F. 2d 843. Judge Swan and I do not believe it was an abuse of judicial discretion to refuse such an allowance of interest in this case.

Affirmed.

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SWAN, *Circuit Judge* (dissenting in part):

I agree with my brother Medina to affirm the judgment insofar as it dismissed the action as against the partners, other than Thomas, of Lehman Brothers. With respect to Thomas, I think he should be held liable in an amount less than the judgment against him awarded Tide-water.

In my opinion we should differentiate between the shares of Tide-water stock purchased *before* and those purchased *after* Thomas, with his partners' consent, withdrew from any participation in the partnership purchases of such

*Opinion*

stock. As to profits attributable to the shares purchased before Thomas' withdrawal, I think it reasonable to hold that Thomas could not relieve himself from liability by transferring to the other partners his share of such profits and, consequently, he can be held to have "realized" such profits within the meaning of the statute. But this argument is inapplicable to the shares purchased after Thomas withdrew. It is my understanding that a partnership agreement can be modified by parol so as to exclude one partner from participating in investments or sharing in the profits or losses on investments made subsequent to the modification. As to profits attributable to the *after*-purchased shares, Thomas had no interest to transfer to Lehman Brothers and I do not see how he can be held to have "realized" any profit on such shares. Consequently I think on Thomas' appeal the cause should be remanded for determination of the correct amount of the judgment to be awarded against him. As to the method of computing the profits and the non-allowance of interest I agree with my brother Medina.

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**CLARK, Circuit Judge (dissenting):**

Against the background of "a widely condemned evil," §16(b) of the Securities Exchange Act of 1934 put teeth into the concept of a corporate director's fiduciary obligation by the simple but arbitrary course of requiring him to disgorge to his corporation "insider" profits from stock speculation obtained under stated circumstances and without regard to his own good faith or innocence. This device has worked successfully where more refined methods might have failed; and although the provision "is probably the most cordially disliked provision in all these statutes from the point of view of those whom it affects," Loss, Securities

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Regulation 578 (1951), yet its policy is so important and so generally approved that repeal seems unlikely, *id.* 579; Cook & Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 612, 641 (1953). In our first case construing it we said, "The statute is broadly remedial," and went on to say: "We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty." *Smolowe v. Delendo Corp.*, 2 Cir., 136 F. 2d 231, 239, 148 A. L. R. 300, certiorari denied *Delendo Corp. v. Smolowe*, 320 U. S. 751. That principle has since shaped our statutory interpretation as well as that of other courts and is restated in our latest and full opinion in *Adler v. Klawans*, 2 Cir., 267 F. 2d 840.

To this uniform interpretation there appears to have been one notable exception, the decision relied on as authoritative here, *Rattner v. Lehman*, 2 Cir., 193 F. 2d 564. That case held that where a director was fortunate enough to be a partner in a brokerage firm which did the actual trading, he and his partners were relieved of liability for insiders' profits perhaps in all cases, but in any event in nearly all. The decision below, affirmed by my brother Medina goes far to complete the process of complete immunity toward which my brother Swan, with relentless logic, tends. I think the principle is anomalous in granting exception in the very cases where the incentive to take insiders' profits is strongest as a part of a trading firm's normal business and where exception is the most difficult to understand. So I believe we should review the ruling in the light of experience and the present-day situation. And at the very least we should request assistance in the form of a brief *amicus curiae* from the S. E. C., which has often been most helpful on mooted issues in the past,

*Opinion*

but which has here not allayed, but has rather added to, the confusion, as I point out hereinafter.

I suggest that re-examination of the *Rattner* precedent is indicated for several reasons: the circumscribed nature of the discussion there had; the teaching of later experience; the equivocal position of the S. E. C.—now apparently clarified contra to the decision; and the confusion as to its possible scope and real or apparent exceptions. My own conclusion is that the case should be overruled or at least limited and that the partners here, including Thomas, should be required to pay Thomas' company the profits they made from short-swing trading in its stock.

The *Rattner* decision appears to be supported on three grounds, two of them stated in the opinion and a third adduced by later commentators. First reliance is placed upon a "literal reading" of the statute. But any reading, literal or otherwise, can hardly avoid the legal meaning of "owner" or eliminate the basic principles of partnership. Under these principles, clearly stated in New York law as embodied in the Uniform Partnership Act, property bought with partnership funds is partnership property, and a partner is co-owner with his partners of specific partnership property holding as a tenant in partnership with an equal right with his partners to possession of specific partnership property and with an equal share in the profits and surplus. N. Y. Partnership Law §§12, 40, 43, 50-52. Moreover, the partnership is charged with knowledge of or notice to a partner. *Id.* §23. I submit that on a literal legal reading of the statute, Thomas was co-owner with all the other partners of the Tide Water stock when bought and of the profits when sold, and that Thomas stood at all times legally charged with full knowledge of what was going on in his firm, just as the other partners had like knowledge. Further, I do not doubt that in any ordinary well run partnership, the practical facts of life actually coincide with these legal facts, and that one partner either

### Opinion

actually knows what is going on in his group or is content to leave action to his colleagues. In any event, the legal situation seems clear—so much so that in my view co-owners cannot be excluded from the operation of the statute without a serious distortion of its terms. Furthermore to close the gap now opened up would require rather awkward and seemingly superfluous phraseology, such as that “owner” actually does include “co-owner.”

A second ground of support for the decision was deduced from the legislative history and from the fact that a provision in earlier drafts which had made liable any person who acted on confidential information disclosed by a director was eliminated from the statute as finally enacted. But as the S. E. C<sup>1</sup> pointed out in its brief *amicus curiae* in *Rattner*, this history, so far as pertinent, really points the other way and in favor of an automatic application of the statute without the necessity of proving the parties' intent. That, too, is the view of the legislative history we emphasized in *Smolowe v. Delendo Corp.*, *supra*, 2 Cir., 136 F. 2d 231, 235, 236. But the *Rattner* decision forces for this important class of cases the very step which we felt Congress had avoided, namely, a “subjective standard of proof, requiring a showing of an actual unfair use of inside information.” 2 Cir., 136 F. 2d 231, 236.

The third ground of support, adduced by some commentators, 25 So. Calif. L. Rev. 475, 478 (1952), 100 U. of Pa. L. Rev. 463, 465 (1951),<sup>1</sup> is the harshness in result of the contrary conclusion. Passing the question whether Congressional intent is to be thus limited, one may question whether this is not an attack on the entire statutory policy which is somewhat misdirected when leveled only at a single consequence as here. Admittedly the statute operates stringently, with burdensome results to individuals,

<sup>1</sup> Other comments on the decision appear in Loss, *Securities Regulation* 585 (1955 Supp.), and Cook & Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 391, 403, 633-634 (1953).

*Opinion*

in many, possibly most, cases. But that seems not a sound reason for excepting its operation in this important and natural field of operation. True, the amounts involved may be large, as is to be expected from the high financial character of the protagonists naturally involved in the trading by Wall Street investment firms. But that may be easily taken as an argument for application of the statute here.<sup>2</sup> I think the exemption of these firms would be hard to explain to the ordinary small-scale director not so exempt and indeed to the investing public generally.

But if the requirement of a subjective standard of proof is to stand, then the question at once arises as to how much. And here the *Rattner* case did at least suggest the possibility of some limitation. The majority expressly declined to consider whether the result might be different had the partner "caused" the firm to make the short-swing transactions. Judge L. Hand in an obviously worried concurrence went further and, assuming for his disposition of the case that the firm had bought and sold the shares without any advice or concurrence by the director-partner, intimated that the result might be different if a firm deputed a partner to represent its interests as a director on the board. Here the evidence of director-participation is rather sharper than Judge Medina intimates and goes so far that it is hard to see what more the director could have done to assist his partners short of doing the trading himself. For in his deposition Thomas stated that he had suggested to his partners "from time to time that I thought TideWater under the new management was an attractive investment" and again, "When the new management came

<sup>2</sup> Enforcement of strict accounting and refund against corporate fiduciaries is not exactly a novel legal idea. See *Gratz v. Cloughton*, 2 Cir., 187 F. 2d 48, 49, certiorari denied 341 U. S. 920; *Berner v. Equitable Office Bldg. Corp.*, 2 Cir., 175 F. 2d 218; *Nichols v. S. E. C.*, 2 Cir. 211 F. 2d 412, 417-418; *Surface Transit, Inc. v. Saxe, Bacon & O'Shea*, 2 Cir., 266 F. 2d 862, 868; *In re Midland United Co.*, 3 Cir., 159 F. 2d 340; *Woods v. City Nat. Bank & Trust Co. of Chicago*, 312 U. S. 262, 268; Loss, Securities Regulation 594 (1955 Supp.).



*Opinion*

in, my opinion was asked of what I thought of it, and after I watched them in, I expressed my opinion freely that I thought the management was first-rate, that the company would do well under that management." He also said that one of the partners with whom he discussed the Tide Water management after he became a director was Mr. Hammerslough, the trading partner who actually directed the firm's purchases of Tide Water stock; and Hammerslough himself testified on deposition that after Thomas became a director he "spoke very highly of the management and prospects of the Tide Water Oil Company, I believe he thought very highly of it." Unless judges are to be incredibly naive as to the facts of financial life, it is difficult to see what Thomas needed to say more to show that the lily was already gilded. The facts as to the proposed Tide Water exchange were published in the Wall Street Journal so that further details as to that would have been quite superfluous. In fact I regard all this discussion whether or not the firm "deputed" its members to sit on many corporate boards as naive. Obviously this was an arrangement of mutual benefit to both sides; what difference can it make in realities which extended the first invitation? And what further official "deputation" is needed more than the mere fact of this mutually beneficial management? So unless *Rattner* is to afford exemption in almost all situations of financial importance, we must reverse to hold that the suggested exceptions here apply to support firm liability.

In this situation the S. E. C. has not yet afforded us its accustomed assistance. In the *Rattner* case its general counsel filed a brief *amicus curiae* wherein it first urged that the statute in terms was to be construed as I have stated above and much of the reasoning I have employed was there adduced in support of its view. Then it undermined its own opinion by urging that it had freed the de-

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defendants of liability by adopting its Rule X-16A-3(b) requiring a partner to file a report to it "only as to that amount of such equity security which represents his proportionate interest in the partnership," and that the defendants were justified in assuming the Commission to hold the other partners not liable here. The court in the *Rattner* case rejected this argument, saying: "The Commission may exempt 'transactions'; but it cannot reduce the liability imposed by Section 16(b)." *Rattner v. Lehman*, *supra*, 2 Cir., 193 F. 2d 564, 566. That the Commission had its doubts at least as to the policy of its rule is shown by the following statement in its *Rattner* brief: "For reasons summarized below the Commission now has substantial doubt as to whether Rule X-16A-3 fully effectuates the statutory purpose of Section 16. It is therefore currently considering amending the rule to limit the broad exemption now implicit in it."

At any rate the Commission soon (1953) amended its rule to require a partner to report the entire amount of the security owned by the partnership, Rule X-16A-8(g), adopted by Sec. Ex. Act Rel. 4801 (1953), now 17 CFR (1960 Supp.) §240.16a-3(b). Loss, Securities Regulation 585-587 (1955 Supp.). And there the matter now stands, with the Commission at odds with our interpretation.

The matter of the validity of such a Commission regulation is obviously still an open one. We expressed doubt as to another rule in *Greene v. Dietz*, 2 Cir., 247 F. 2d 689, which was thereafter held invalid in *Perlman v. Timberlake*, D. C. S. D. N. Y., 172 F. Supp. 246; but the contrary was held in *Continental Oil Co. v. Perlitz*, D. C. S. D. Tex., 176 F. Supp. 219. Seemingly the Commission still relies on its power under the statute. See *Timbers, Management Compensation Plans: SEC Problems*, Proceedings of the Second Annual Institute on Corporate Counsel, April 21, 22,

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1960 (Fordham Univ. Press) 28, 37-38; Meeker & Cooney, *The Problem of Definition in Determining Insider Liabilities Under Section 16(b)*, 45 Va. L. Rev. 949, 957 (1959); Cook & Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 612, 632-635 (1953); Loss, *Securities Regulation* 578 (1951). This is an obvious state of confusion and uncertainty which is unfortunate to the public, the investors, and their traders. I do not believe any inference can be drawn from the failure of Congress to act to correct the *Rattner* decision; that body has lately been interested in other matters more immediately troublesome than that of the regulation of private investments and the S. E. C. obviously has not given it positive leadership. So it would seem to me that at least before we dispose of this vastly important issue we should ask the S. E. C. for its informed comments.

I should add that I agree with the method of computation, finding a "purchase" under §16(b) and a total profit to the firm of \$98,686.77, which Judge Dawson followed and Judge Medina approves in his opinion. But this computation, upon which we all agree, highlights the anomaly of the ultimate conclusions reached by my brothers. For they are forced to concede that insider profits were made and that there must be restitution to the corporation, but then they differ widely as to how much is to be restored. It seems to me that neither of their results can be justified logically or legally under any principles of the law of partnership with which I am familiar. I submit that if there were insider profits (as their concession shows) then the partnership and the individual partners must be held liable to return these profits in full to Tide Water. And that should be our decision. The final anomaly in our exceptional treatment of this case is the denial of all interest for the use of the sums found due the corporation, con-

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trary to our uniform practice in other cases. *Magida v. Continental Can Co.*, 2 Cir., 231 F. 2d 843, 848, certiorari denied *Continental Can Co. v. Magida*, 351 U. S. 972; *Blau v. Mission Corp.*, 2 Cir., 212 F. 2d 77, 82, certiorari denied *Mission Corp. v. Blau*, 347 U. S. 1016; *Park & Tilford v. Schulte*, 2 Cir., 160 F. 2d 984, 988, 989, certiorari denied *Schulte v. Park & Tilford*, 323 U. S. 761. If there are special equities here, they have not been stated.

I would reverse and remand for the entry of a judgment returning to the Tide Water corporation all the profits made from the transaction by the defendants, together with interest and costs.

**Dissenting Opinion.**

**UNITED STATES COURT OF APPEALS**

**FOR THE SECOND CIRCUIT**

**No. 51—October Term, 1960.**

(Motion submitted January 9, 1961

Decided February 21, 1961.)

**Docket No. 25846**

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**ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,**

*Plaintiff-Appellant-Appellee,*

**ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of LEHMAN BROTHERS,**

*Defendants-Appellees,*

**JOSEPH A. THOMAS,**

*Defendant-Appellee-Appellant,*

**TIDE WATER ASSOCIATED OIL COMPANY,**

*Defendant-Appellee.*

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*Dissenting Opinion*

*Motion for Leave to Participate as Amicus Curiae and  
to File Petition for Rehearing*

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WALTER P. NORTH, General Counsel, Securities &  
Exchange Commission, Washington, D. C.,  
*for Securities & Exchange Commission.*

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Motion for leave to participate as *amicus curiae* and to  
file petition for rehearing is denied.

T. W. S.  
H. R. M.  
U. S. C. JJ.

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I dissent and vote for a rehearing *in banc*.

C. E. C.  
U. S. C. J.

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*Petition for Rehearing in Banc*

The active judges, having voted to deny the petition for  
rehearing *in banc*, except Judges Clark and Smith who dis-  
sent and vote to grant the petition, the petition is denied.

J. EDWARD LUMBARD  
*Chief Judge*

February 21, 1961



*Dissenting Opinion*

CLARK, *Circuit Judge* (dissenting):

The court's refusal by majority vote to take any steps to abate the confusion resulting from the decision by our senior panel has striking connotations beyond those affecting the central issue on the merits, important as that is. Chief among these added consequences is the precedent—the first time in our history—of refusing the assistance of the Securities and Exchange Commission, here proffered as a result of the need therefor expressed by the writer as a member of the court. This re-enforces the harsh refusal of the original panel majority. Under the peculiar circumstances here present making S. E. C. advice more relevant even than usual, I should have thought that we would have accepted the offer with alacrity, whatever our eventual views as to the merits; and I am chagrined that an individual judge's "right to know" is thus so severely circumscribed. Some instances where such help has been gladly received, as well as others where its absence is deplored, are noted in *Greene v. Dietz*, 2 Cir., 247 F. 2d 689, 696. Even in the case which is being treated as controlling here, *Rattner v. Lehman*, 2 Cir., 193 F. 2d 564, the court, although rejecting the Commission's advice in part, nevertheless paid it the compliment of devoting a major part of its discussion to the Commission's presentation. I submit with deference that the correct approach here was that followed in *Greene v. Dietz*, *supra*, 2 Cir., 247 F. 2d 689, 697:

"Although neither appellant nor appellee sought a rehearing in this case, the Securities and Exchange Commission timely filed an application with us seeking our permission to file a petition, *amicus curiae*, for a rehearing. *We readily granted such permission.* [Emphasis added.] The Commission represents to us that our opinion of June 7, 1957 should be clarified \* \* \*. We are grateful to the Commis-

*Dissenting Opinion*

sion for the interest it has shown, and we order that the brief offered by it in support of its petition be filed and made a part of the records in the case."

In my original dissent I pointed out why S. E. C. advice seemed particularly desirable here. In addition to the expertise which the Commission and its staff must necessarily have acquired over the years in an area particularly committed to its care, there were the special considerations that the Commission has long required reporting by trading partnerships of all insider short-swing profits acquired by them and hence must know the dimensions of the problem and further that the Commission had made changes in its regulations signifying lack of confidence in the *Rattner* rule, the rationale for which changes surely would be enlightening. Now the reasons presently stated by the Commission for its appearance intensify this need for enlightenment. For it requests granting of its petition for rehearing "so as to permit the Commission to urge that this Court in its decision should overrule its earlier interpretation of Section 16(b) of the Securities Exchange Act of 1934 as enunciated in *Rattner v. Lehman*, 193 F. 2d 564." An explanation of its reasons for coming to its present conclusion could hardly fail to be instructive.

My brothers offer no explanation of their decision, and the grounds therefor can only be inferred. But since a decision on the merits is avoided in a situation where the need therefor is great, it is probably a fair inference that procedural barriers were thought to exist. It is believed, however, that actually none such are discoverable. As concerns the S. E. C. it has followed the exact procedure found acceptable in *Greene v. Dietz*, *supra*, 2 Cir., 247 F. 2d 689. The Commission states that it refrained from seeking to enter earlier because of its conclusion that the case here would turn on issues of fact—a very reasonable deduction, since *Rattner* had assumed to settle the law. Undoubtedly, too, rejection of its views in the *Rattner*

*Dissenting Opinion*

case obviously suggested caution until it received something approaching an invitation from members of the court. And if we are at all realistic we must recognize that changes in Commission personnel may well have resulted in a new and different policy.

The S. E. C. application is now supported by the plaintiff. Here, too, there seems to be some implication that he has been dilatory. But I do not see how this can be sustained. Notwithstanding the two long holiday week ends immediately after our decision he moved with due promptness, and within the 15 days stated in our Local Rule 25(a), for certification of the case to the Supreme Court. While this may not have been good tactics in view of our customary unwillingness to certify, yet it does show his desire and speedy attempt to secure some form of review. Upon denial of his motion by a divided court and the intervening application by the S. E. C., he promptly filed his motion and affidavit supporting the request of the S. E. C. to be heard *in banc*. Thus at no time has our decision become final, and it will not become so until the filing of the present order. Obviously there has been no prejudice to anyone by any supposed delay. Moreover, it has been our uniform practice to grant additional time for presentation of petitions for rehearing, since we have preferred to terminate the process of adjudication by decisions on the merits rather than by application of some newly fashioned time barriers. Indeed I can recall no case where we have ever rejected a meritorious petition for rehearing on the ground that it was untimely. The fashioning of procedural rules *ad hoc* to avoid decision on the merits is always to be deplored. Clark, Code Pleading 71 (2d Ed. 1947).

I am bound to add that I consider all these implications of procedural barriers irrelevant; for even if these suitors could have been considered in default as private claimants, yet we must not overlook the fiduciary character in which they here appear. Both the Commission and the plaintiff

*Dissenting Opinion*

are trustees of the public interest; their private interest is either nominal or, in the case of the Commission, non-existent. At best they do but remind us of our own public responsibility. In such case I doubt if a few days' delay in the holiday season can properly be seized upon by us as justifying our inaction in the public regard. Consideration on the merits, far from according succor to the lag-gard, would be but a proper response to a judicial obligation to do justice to all, however incompletely represented.

But, whatever the reasons to be assigned for the result, it leaves this important area of the law almost ludicrously uncertain. What now is the present force to be assigned to *Rattner*? Although it is assumed to compel the present decision, yet quite significantly not a single word in its defense has been uttered by any of the eight judges here engaged. My own criticisms uttered in my dissent have remained unanswered and have now, as is apparent, the support of the S. E. C. But even further, Judge Medina, in writing the main opinion and though he held himself bound by the decision, uttered as strong a criticism of its results as has appeared, in supporting the fundamentally inconsistent ruling that the partner-director must give up something representing his share of insider profits to the corporation. And in this Judge Swan concurred, although agreeing neither on the principle nor on the actual amount of the recovery. It is indeed ironical that so disfavored a precedent<sup>1</sup> nevertheless has apparent power to control even to the extent of ruling out proper restrictions or exceptions there at least implied with respect to a director who gives actual investment advice.

The most serious vice of the *Rattner* decision is the unfair discrimination it builds into an important remedial statute—a discrimination substantially eliminating the

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<sup>1</sup> It has remained uncited elsewhere except for one purely incidental reference in *Lekman v. Civil Aeronautics Board*, D. C. Cir., 209 F. 2d 289, 294, n. 9, certiorari denied 347 U. S. 916.

*Dissenting Opinion*

great Wall Street trading firms from the statute's operation. So great is the unfairness of the result that, notwithstanding its remedial nature, the statute, it would appear, should not stand unless its judicially discovered defects can be corrected. But before that conclusion is finally reached let us hope that the S. E. C. may discover some tribunal prepared and willing to listen to its arguments.

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**SMITH, Circuit Judge:**

I join in the dissent of Clark, C. J.

**Statutes.**

Sections 16(a) and 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sections 78p(a) and 78p(b), provide as follows:

"(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial

*Statutes*

owner, director or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Securities and Exchange Rule X-16A-3(b), 240.16a-3(b), as amended, provides as follows:

"A partner who is required under Sect. 240.16a-1 to report in respect of any equity security owned by the partnership shall include in his report the entire amount of such equity security owned by the partnership. He may if he so elects, disclose the extent of his interest in the partnership and the partnership transactions."



**Judgment of Affirmance.****UNITED STATES COURT OF APPEALS,****FOR THE SECOND CIRCUIT.**

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the twentieth day of December one thousand nine hundred and sixty.

**Present:**

HON. THOMAS W. SWAN,  
HON. CHARLES E. CLARK,  
HON. HAROLD R. MEDINA,  
Circuit Judges.

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ISADORE BLAU, a Stockholder of Tide Water Associated Oil Company,  
*Plaintiff-Appellant,*

v.

ROBERT LEHMAN, et al.,  
*Defendants-Appellees,*

and

JOSEPH A. THOMAS,  
*Defendant-Appellant,*

TIDEWATER ASSOCIATED OIL COMPANY,  
*Defendant.*

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*Judgment of Affirmance*

**Appeal from the United States District Court for the Southern District of New York.**

**This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.**

**ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed.**

**A. DANIEL FUSARO,**  
Clerk.

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# In the Supreme Court of the United States

OCTOBER TERM, 1960

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No. 810

ISADORE BLAU, ETC., PETITIONER

v.

ROBERT LEHMAN, ET AL.

---

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

---

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS  
AMICUS CURIAE

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## OPINIONS BELOW

The opinions of the court of appeals (Pet. 1a-22a and 23a-29a) have not yet been reported. The opinion of the district court (R. 149a-157a) <sup>1</sup> is reported at 173 F. Supp. 590.

## JURISDICTION

The judgment of the court of appeals was entered on December 20, 1960 (Pet. 32a-33a). Petitioner's motion for rehearing was denied by the court *en banc* on February 21, 1960 (Pet. 23a-24a). The petition

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<sup>1</sup>"R." refers to the joint appendix filed in the court of appeals.

for a writ of certiorari was filed on March 14, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

#### **QUESTION PRESENTED**

Where one partner of a firm which has been trading in a corporation's stock registered on a national securities exchange is a director of the corporation, may the corporation recover the entire "short-swing" profits realized by the partnership under Section 16(b) of the Securities Exchange Act of 1934 or is recovery limited to the partner-director's proportionate share of the profits?

#### **STATUTE INVOLVED**

Sections 16(a) and 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(a) and 78p(b), are reproduced in full in the Appendix to the Petition (Pet. 30a, 31a).

#### **STATEMENT**

The stock of Tide Water Associated Oil Company ("Tide Water") is registered on the New York Stock Exchange. The petitioner brought this action on behalf of Tide Water under Section 16(b) of the Securities Exchange Act of 1934 to recover the profits realized by the firm of Lehman Brothers from purchases and sales of Tide Water stock within a period of less than six months. The complaint invoked the jurisdiction of the court under Section 27 of the Securities Exchange Act of 1934.

Lehman Brothers is a partnership and a member of the New York Stock Exchange and other stock exchanges. The firm is engaged in the investment bank-

ing business, acts as a broker in securities, and trades in securities for its own account. The members of the firm hold directorships in a number of corporations (R. 32a-33a).

During the period October 8, 1954, to November 15, 1954, Lehman Brothers purchased for its own account 50,000 shares of Tide Water common stock (R. 43a-44a, 49-50a). On December 8, 1954, it converted these shares into a like amount of Tide Water preferred stock (R. 86a). The district court held that these acquisitions of the preferred stock constituted a "purchase" within the meaning of Section 16(b) (R. 156a). Lehman Brothers sold the preferred stock at a profit of \$98,686.77 within six months of these acquisitions (R. 87a, 156a).

The respondent, Joseph A. Thomas, was both a partner of Lehman Brothers and a director of Tide Water during the period when all the above transactions took place (R. 5a, 25a). Prior to the purchases, Thomas had spoken "very highly of the management and prospects of" Tide Water to the partner of Lehman Brothers who authorized the firm's purchase of Tide Water common stock (R. 69a-70a). However, when Thomas learned of the first purchases, he instructed the other partners that he would not participate in any of the firm's profits from these transactions (Pet. 4a-5a).

After a trial without a jury, the district court dismissed the complaint as against Lehman Brothers and entered judgment against Thomas in the amount of \$3,893.41, which represented his proportionate interest in the partnership profits from the transactions



involved. No interest was allowed by the court (R. 158a). The court of appeals affirmed by a divided court (Pet. 2a-22a).

**REASONS FOR GRANTING THE WRIT**

The adoption by Congress of the Securities Exchange Act of 1934 (15 U.S.C. 78a, *et seq.*) was the result of the most extensive congressional study ever conducted of stock exchange and over-the-counter practices and abuses. One of the reforms which the Congress found to be urgently needed for the protection of the investing public is embodied in Section 16 of the Act, which seeks to discourage speculation by fiduciaries in shares of their own companies. The need for the measure was clearly stated in one of the Committee reports (S. Rep. No. 1455, 73d Cong., 2d Sess., p. 55):

Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others.

Accordingly, Section 16(a) was drafted to require disclosure of all changes in ownership of equity securities by "[e]very person who is directly or indi-

rectly the beneficial owner of more than ten per centum of any class of any equity security \* \* \* registered on a national securities exchange, or who is a director or an officer of the issuer of such security." Section 16(b) was originally drafted to impose liability where trading occurred on the basis of inside information. Because of the anticipated difficulty of proving in each case whether confidential information had actually been used, it was ultimately decided to eliminate that requirement and use a "rule of thumb" imposing liability on the officers, directors, and ten-per-cent shareholders who profit from buying and selling, or selling and buying, the equity securities of their corporations within a six-month period, regardless of their subjective intent.<sup>2</sup>

The court below has previously ruled on the question whether Section 16(b) encompasses all of the "short-swing" profits realized by a partnership of which a director is a member. In *Rattner v. Lehman*, 193 F. 2d 564 (C.A. 2), which also involved the respondent partnership (or its predecessor), the court held that liability extended only to the proportionate share of a partner-director's interest in his firm. The court's opinion stated that it was not necessary to determine "[w]hether the result might be different" had the partner caused the firm to make the short-swing transactions (193 F. 2d at 565). That case was decided by then Chief Judge Swan, and Judges Learned Hand and Augustus N. Hand. In a concurring opinion, Judge Learned Hand made it clear

<sup>2</sup> See Hearings before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., pursuant to S. Res. 84, 72d Cong., and S. Res. 56 and S. Res. 97, 73d Cong., p. 6557.

that he assumed "that Lehman Brothers bought and sold the shares without any advice or concurrence by" the partner-director and added that he was "not prepared to say" that "if a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable" (*id.* at 566, 567).

In the present case, Judge Medina noted that he and Judge Swan disagreed with the implication in Judge Hand's concurring opinion. He stated: " \* \* \* we do not see how any sort of deputizing can make the partners of the partnership a 'director' within the meaning of Section 16(b)," but he indicated that this conclusion was not essential to their decision (Pet. 6a-7a). He also noted that the partner-director "had provided no confidential information whatever" (Pet. 4a), and did not even know that the partnership was considering the transaction. He held that the amount of profits recoverable from a partner-director must be "the share of the profits to which he would be entitled, irrespective of any waiver or disclaimer by him," stating that if "the director himself can escape by the mere device of a waiver and disclaimer, we shall have opened a breach in the law through which stockbrokers and investment banking houses, those most likely to be in a position to profit by the use of confidential information in stock speculation, can pass with impunity" (Pet. 10a-11a).

Judge Swan joined in the decision to dismiss as against all the partners who were not directors but dissented from the decision so far as it included the profits of the partner-director which arose from

shares purchased after the latter's withdrawal from participation in partnership profits (Pet. 13a-14a).

Judge Clark was of the view that, since all the partners were co-owners of the stock in which the transactions occurred, they could not "be excluded from the operation of the statute without a serious distortion of its terms" (Pet. 17a). He pointed out that any "subjective standard of proof" forces the very step which Congress had intended to avoid.

We submit that these five different opinions by the judges who have considered this question in the court below indicate the need for review by this Court, particularly since this very important section has never been before this Court.

While the courts have generally interpreted Section 16(b) so as to carry out the legislative intention "to squeeze every possible penny of profit out of such [short swing] transactions" (Pet. 10a),<sup>\*</sup> the decision in

<sup>\*</sup> See *Smolowe v. Delendo Corporation*, 136 F. 2d 231, 239 (C.A. 2), certiorari denied, 320 U.S. 751; *Park & Tilford v. Schulte*, 160 F. 2d 984, 988 (C.A. 2), certiorari denied, 332 U.S. 761; *Gratz v. Claughton*, 187 F. 2d 46, 50 (C.A. 2), certiorari denied, 341 U.S. 920; *Blau v. Mission Corp.*, 212 F. 2d 77, 81 (C.A. 2), certiorari denied, 347 U.S. 1016; *Stella v. Graham-Paige Motors Corp.*, 232 F. 2d 299, 307 (C.A. 2), certiorari denied, 352 U.S. 831; *Adler v. Klawans*, 267 F. 2d 840, 847 (C.A. 2); *Blau v. Allen*, 163 F. Supp. 702, 704 (S.D.N.Y.); *Arkansas Louisiana Gas Co. v. W. R. Stephens Investment Co.*, 141 F. Supp. 841, 847 (W.D. Ark.); Cf. *Green v. Dietz*, 247 F. 2d 689 (C.A. 2); *Magida v. Continental Can Co.*, 231 F. 2d 843 (C.A. 2), certiorari denied, 351 U.S. 972; *Walet v. Jefferson Lake Sulphur Co.*, 202 F. 2d 433 (C.A. 5), certiorari denied, 346 U.S. 820; *Fistel v. Christman*, 133 F. Supp. 300 (S.D.N.Y.); *Lockheed Aircraft Corp. v. Campbell*, 110 F. Supp. 282 (S.D. Cal.); *Blau v. Hodgkinson*, 100 F. Supp. 361 (S.D.N.Y.); *Grossman v. Young*, 72 F. Supp. 375 (S.D.N.Y.).

this case has given only token effect to that legislative purpose by allowing recovery of only a fraction of the "short-swing" profit realized by the partnership. Where inside information is obtained from a partner director and used as a basis for a firm's trading, there is a great opportunity for the kind of unfair profits that the Congress has tried to eliminate.

To deprive the partner of only the share of partnership profits which he would normally receive is an ineffective deterrent to a partnership's trading on inside information. A partner who sacrifices his profit in one series of transactions would be compensated in whole or part from profits made in transactions by the firm in shares of other companies, in which some other partners are directors. The Commission's public records disclose that the 23 partners of Lehman Brothers hold over 100 directorships (SEC File No. 801-364), many of which are in companies registered on national securities exchanges. A study conducted in 1956 found that members of the 19 largest investment banking firms in the country held 254 positions as officers or directors in one or more of 1,642 of the nation's largest industrial companies.\*

Accordingly, the easy evasion permitted by *Rattner* and the decision below represents a serious departure from the usual judicial treatment of the broadly remedial provision of Section 16(b) and, if allowed to stand, would virtually nullify the statute's effectiveness in a most crucial area of operation.

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\* See Report of the House Select Committee on Small Business, 85th Cong., 1st Sess., pp. 74-81.

As Judge Clark pointed out, the decisions below substantially eliminate the great Wall Street trading firms from the statute's objectives. These firms, like much of the securities industry, are customarily organized as partnerships and, as we have noted, their partners often hold directorships in the nation's largest listed companies. With their giant resources, this group has not only the maximum opportunity, but the greatest temptation, to engage in the vice which the statute was designed to eliminate. Since the decision below would have the practical effect of substantially eliminating these firms from the application of the statute, we agree with Judge Clark that there is "unfair discrimination" of great significance.

While the interpretation of federal statutes is not dependent upon state law, we must assume that in adopting the statute the Congress was not unmindful of basic partnership concepts that are part of the fabric of the common law. A partner-director has no separate interest in specific partnership assets; he has an undivided interest in the partnership profits. The partnership is responsible for the acts of its partners in carrying out firm business. We need not urge that Thomas' directorship made the firm a "director" within the meaning of Section 16(b), but it cannot be seriously contended that a partner's directorship is unrelated to firm business in view of the recurring pattern reflected in the study referred to above.\*

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\* See also *Lehman v. Civil Aeronautics Board*, 209 F. 2d 289, 294 (C.A. D.C.).



The courts within the Second Circuit, which encompasses the nation's largest financial community and the center of the country's securities industry, have decided a majority of the cases involving Section 16(b). Decisions in that circuit are, therefore, particularly important to the operation of this statute.

#### CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be granted.

Respectfully submitted.

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APRIL 1961.



BLACK, J.

Office Supreme Court, U.S.  
**FILED**  
APR 7 1961  
BROWNING, Clerk

**Supreme Court of the United States**

OCTOBER TERM, 1960

N [REDACTED] 66

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,  
*Petitioner,*  
—against—

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMER-SLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of Lehman Brothers, JOSEPH A. THOMAS, and TIDE WATER ASSOCIATED OIL COMPANY,  
*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

**BRIEF OF RESPONDENTS OTHER THAN  
TIDE WATER ASSOCIATED OIL COMPANY  
IN OPPOSITION**

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# Supreme Court of the United States

OCTOBER TERM, 1960

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

*Petitioner,*

*—against—*

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of Lehman Brothers, JOSEPH A. THOMAS, and TIDE WATER ASSOCIATED OIL COMPANY,

*Respondents.*

No. 810

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## **BRIEF OF RESPONDENTS OTHER THAN TIDE WATER ASSOCIATED OIL COMPANY IN OPPOSITION**

### **Question Presented**

(a) Where a partnership buys and sells securities of an issuer within a period of six months, and

(b) where a member of the partnership is a member of the Board of Directors of the issuer, and

(c) where the partner-director did not consult the firm with reference to the purchase or sale or with reference to any of the affairs of the issuer and disassociated himself from the transaction as soon as he first learned of it, and

(d) where the partner-director, in fact, received none of the profits of the transaction—was not the Court of Appeals correct in holding that the partnership was not liable to account to the issuer for its profits and that the partner-director was not liable for more than what would have been his pro rata share had he received it?

### **Statute Involved**

The relevant sections of the Securities Exchange Act of 1934 provide:

Section 3(a) (Title 15 U. S. C. § 78c(a))  
 “When used in this chapter, unless the context otherwise requires—

\* \* \*

(7) The term ‘director’ means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated.”

Section 16(a) (Title 15 U. S. C. § 78p(a))  
 “Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close

of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

*in part*

Section 16(b) (Title 15 U. S. C. § 78p(b))  
 "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Section 23(b) (Title 15 U. S. C. § 78w(b))  
 "The Commission and the Board of Governors of the Federal Reserve System, respectively, shall include in their annual reports to Congress such information, data, and recommendation for further legislation as they may deem advisable with regard to matters within their respective jurisdictions under this chapter."

### Statement

Defendant Joseph A. Thomas was, at the time of the transaction involved, a member of the firm of Lehman Brothers, and a director of Tide Water Associated Oil Company ("Tide Water"). On the basis of the evidence adduced at the trial, the District Court found as a fact that the invitation to Thomas to join the Tide Water board was upon Tide Water's initiative and that Thomas accepted the directorship because of his interest in the oil business and the prestige to be gained in serving on the board of directors of a large corporation (R. 150a).<sup>\*</sup> The District Court found that there was no evidence that Lehman Brothers had deputized Thomas to represent its interests as a director on the Tide Water board (R. 153a).

Between October 8, 1954 and November 15, 1954, acting solely on the basis of two newspaper articles (R. 151a), Lehman Brothers purchased in the regular course of its business 50,000 shares of Tide Water common stock at an aggregate cost of \$1,330,800 (R. 150a). On December 8, 1954, pursuant to a plan of recapitalization, Lehman Brothers exchanged its 50,000 shares of Tide Water com-

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<sup>\*</sup>References preceded by the letter "R." are to pages of the Joint Appendix filed with the United States Court of Appeals for the Second Circuit. The other record references are to the appendix to the petition.



mon stock for 50,000 shares of a new preferred stock (R. 151a). Between December 9, 1954 and March 8, 1955 Lehman Brothers sold its 50,000 shares of preferred stock, realizing in the aggregate the sum of \$1,361,186.77 (R. 151a). On an investment of approximately one and one-third million dollars Lehman Brothers realized a profit of \$30,386.77.

The District Court found as a fact that the purchase of the common stock of Tide Water by Lehman Brothers was made at the direction of the partners constituting the investment committee of the firm, of which Thomas was not a member; that Thomas was not consulted by his partners as to the proposed plan of recapitalization of Tide Water or the proposed purchase by Lehman Brothers of Tide Water stock; and that he was not consulted by them with reference to any of the affairs of Tide Water and said only that he believed Tide Water was a good company under good management (R. 150a).

The Court of Appeals affirmed the District Court's findings of fact (4a, 7a, 9a). Thus both lower courts have concurred in findings of fact that Thomas was not deputized to protect the interests of Lehman Brothers or to become its representative and that the Tide Water stock was bought and sold by the firm without consultation with Thomas, without his concurrence and without his advice. See *Graver Mfg. Co. v. Linde Co.*, 336 U. S. 271, 275 (1949), affirmed on rehearing, 339 U. S. 605 (1950).

As soon as Thomas learned of the firm's first acquisition of Tide Water common stock, he instructed the firm's controller "to exclude me from any risk of the purchase or any profit or loss from the subsequent sale and take the necessary steps to carry out my instructions." (4a). At a partnership meeting Thomas' partners agreed that he was not a part of the Tide Water transaction (5a).

## **Reasons for Denying the Writ**

There are no special or important reasons for granting the writ of certiorari. The decision below was required by the clear words of the statute, is in accord with long standing precedent, and is not in conflict with other authorities. The decision was one of limited application, depending upon the facts of this case.

## **ARGUMENT**

### **I**

#### **THE DECISION BELOW REPRESENTS A PLAIN APPLICATION OF THE STATUTE TO THE FACTS OF THIS CASE AND IS NOT IN CONFLICT WITH OTHER AUTHORITIES**

The issue posed by petitioner arises under a federal statute which imposes liability upon a director for "any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . ."

The words of the statute are clear and they are precise. The term director is defined in Section 3a(7) of the Securities Exchange Act to mean ". . . any director of a corporation or any person performing similar functions . . ." There was no proof that any of the 17 individual respondents other than Thomas was a director or fulfilled the functions of a director of Tide Water, and it is evident that Section 16(b) does not purport to cover them. Moreover, a provision in earlier drafts of the Securities Exchange Act to make liable any person who acted on confidential information disclosed by a director was eliminated from the statute as finally enacted. See *Smolow v. Delendo Corporation*, 136 F. 2d 231, 236 (2d Cir. 1943), certiorari denied, 320 U. S. 751 (1943).

Petitioner's argument that Thomas himself, is liable for the profits realized by the other respondents is also directly contradicted by the plain words of Section 16(b). They impose liability upon a director only for profits "realized by him"; they do not impose liability upon a director for profits realized by others, whether they be friends, relatives, partners or others who may be close to him.

Petitioner argues that the Partnership Law of New York State made Thomas a co-owner with the other respondents of the securities purchased by Lehman Brothers. That argument ignores the finding that Thomas' capital was not at risk (4a) and it ignores the agreement between Thomas and his partners that he "was not a part of this Tide Water transaction at all" (5a). Petitioner's argument would not be pertinent even if Thomas had been an owner of the Tide Water securities because it is not the ownership of securities but the realization of profits which imposes liability. Thomas did not in any sense of the word realize the profits received by the other respondents, and under Section 52 of the Partnership Law of New York State he had no interest in their shares of the profits.\*

The decision below is in exact accord with the precedent established in *Rattner v. Lehman Brothers*, 193 F. 2d 564 (2d Cir. 1952). There the defendant-partnership purchased and sold 5,000 shares of the common stock of the issuer within a period of six months while one of its partners was a director of the issuer. The court held that the partners of the partner-director were not liable for the firm's profits, stating at page 566:

"... Section 16(b) contains no provision requiring the partners of a director to account for profits realized by them. The appellant argues that

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\*Section 52 of the New York Partnership Law provides: "A partner's interest in the partnership is his share of the profits and surplus and the same is personal property."

to construe the section so literally as to exclude them leaves a dangerous loophole in the statute. But the legislative history indicates that the omission of any provision for such liability was intentional . . ."

The court also held that the partner-director was not liable for more than his proportionate share of the firm's profits because the statute does not impose liability upon a director for profits realized by other persons.

Following the decision in *Rattner*, the Securities and Exchange Commission, in connection with an amendment of its Rule X-16A-3(b), issued Release No. 4754 on September 24, 1952 which states:

" . . . The new rule X-16A-3 requires any person who is a member of a partnership which owns securities of an issuer of which he is an officer, director, or ten per cent stockholder to report all holdings and all changes in the beneficial ownership of equity securities of that issuer held by the partnership. *It is not intended as a modification of the principles governing liability for shortswing transactions under section 16(b) as set forth in the case of Rattner v. Lehman*, 193 F. 2d 564. . . ." (Emphasis supplied)

It is difficult to perceive how petitioner can so blandly argue that the amendment of Rule X-16A-3(b) constituted the enunciation of a doctrine contrary to *Rattner* in the light of the Commission's express words.

Moreover, Section 23(b) of the Securities Exchange Act imposes a duty upon the Commission to recommend to Congress legislation which it deems advisable. An examination of all the Commission's annual reports to Congress since the *Rattner* decision reveals that the Commission has made many recommendations to Congress for legislation to correct what it considered to be defects in the Securities Exchange Act of 1934; it does not reveal that the

Commission ever recommended that Congress amend Section 16(b) of the Act so as to impose the liability which petitioner claims should be imposed.

No decision in conflict with *Rattner* has been handed down by any court; and Congress, in the nine years since the decision in *Rattner*, has chosen not to amend the statute so as to impose the liability here contended for. See *Toolson v. New York Yankees, Inc.*, 346 U. S. 356 (1953).

Petitioner would also have this Court review the holdings of the Court of Appeals that the District Court's refusal to award interest on the judgment against defendant Thomas for his pro rata share of the partnership profits was not an abuse of discretion. In *Board of Commissioners v. United States*, 308 U. S. 343 (1939), this Court pointed out at page 352:

" . . . The cases teach that interest is not recovered according to a rigid theory of compensation for money withheld, but is given in response to considerations of fairness. It is denied when its exaction would be inequitable. . . ."

Speaking with regard to a judgment under Section 16(b), the Court of Appeals, in accordance with the teaching of the *Board of Commissioners v. United States*, *supra*, has held that an allowance of interest from the time of realization of profit is not mandatory. See *Magida v. Continental Can Company*, 231 F. 2d 843, 848 (2d Cir. 1956), certiorari denied, 351 U. S. 972 (1956).

The decision not to award interest was a matter within the discretion of the District Court. The Court of Appeals held that the District Court's refusal to award interest in the circumstances of this case was not an abuse of that discretion (13a). A review of that holding is surely not the function of a writ of certiorari.

The decision below is based upon the concurrent findings of fact of two courts. It is squarely in accord with long established precedent which has been accepted by Congress, and in these circumstances review by this Court is unnecessary.

**CONCLUSION**

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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BLAU, J.

Office Supreme Court, U.S.

FILED

31 AUG 18 1961

JAMES R. BROWNING, Clerk

IN THE  
**Supreme Court of the United States**

**October Term, 1961.**

No. 66.

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

*Petitioner,*

*against*

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMER-SLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of LEHMAN BROTHERS, JOSEPH A. THOMAS and TIDE WATER ASSOCIATED OIL COMPANY,

*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

**PETITIONER'S BRIEF.**

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IN THE  
**Supreme Court of the United States**  
October Term, 1961.

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No. 66.

---

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

*Petitioner,*

*against*

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of LEHMAN BROTHERS, JOSEPH A. THOMAS and TIDE WATER ASSOCIATED OIL COMPANY,

*Respondents.*

---

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF  
APPEALS FOR THE SECOND CIRCUIT.

**PETITIONER'S BRIEF.**

### **Opinions Below.**

The majority and dissenting opinions of the Court of Appeals are reported in 286 F. 2d 786 (R. 174-192; 199-203). The opinion of the District Court (R. 149a-157a) is reported in 173 F. Supp. 590.

### **Jurisdiction.**

The judgment of the Court of Appeals was entered on December 30, 1960 (R. 193). The order of the Court of Appeals which denied the petition for rehearing *in banc* (two judges dissenting) was entered on February 21, 1961 (R. 199, 204-205).

The jurisdiction of this Court rests upon 28 U. S. C. Section 1254(1) which is made applicable by Section 27 of the Securities Exchange Act of 1934 (15 U. S. C. Sect. 78aa). The petition for a writ of certiorari was filed on March 14, 1961 and was granted April 24, 1961 (81 S. Ct. 1048; R. 205).

### **The Statute and Regulation Involved.**

Pertinent provisions of the Securities Exchange Act of 1934, Sections 16(a), 16(b) and 3a(13), 15 U. S. C. A. Sects. 78p(a), 78p(b) and 78e(a) (13), pp. 419, 362, are set forth in the Appendix, *infra*, pp. 51-52. Pertinent provisions of the Securities and Exchange Commission Rule X-16A-3(b), as amended October 4, 1952, 17 CFR 240.16a-3(b), p. 149, Cum. Supp., are set forth in the Appendix, *infra*, p. 53.

### Questions Presented for Review.

1. Under Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A. Sect. 78p(b), where one of the members of a co-partnership firm is a director of a corporation having equity securities listed upon a National Securities Exchange, is the *co-partnership* liable to such corporation for the "short-swing" profits realized by the firm from its purchases and sales of the corporation's equity securities within a period of less than six months?

2. Under Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A. Sect. 78p(b), where one of the members of a co-partnership is a director of a corporation having equity securities listed upon a National Securities Exchange, to what extent is such *partner-director* liable to the corporation for "short-swing" profits realized by his co-partnership firm as a result of its purchases and sales of the corporation's equity securities within a period of less than six months?

3. Under Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A. Sect. 78p(b), when a corporation is granted a judgment against an "insider" for the recovery of "short-swing" profits realized by him as a result of his purchases and sales of the corporation's equity securities within a period of less than six months, is the corporation entitled to recover interest upon such profits from the date they were realized and recoverable under the statute?

### Statement of Facts.

The action was instituted by petitioner, Isadore Blau, as stockholder of Tide Water Associated Oil Company (hereinafter referred to as "Tide Water"), pursuant to Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sect. 78p(b), to recover the profits real-



ized by respondent, Lehman Brothers, from its purchases and sales of Tide Water's listed securities within a period of less than six months (R. 4a-6a).

During the times complained of the individual respondents were general partners in the firm known as Lehman Brothers, and will be referred to collectively by such name. The respondent, Joseph A. Thomas, one of the firm's general partners, was at the same time also a director of Tide Water (R. 4a, 5a, 7a).

Lehman Brothers is in the investment banking business; it is also a member of various stock exchanges, and trades in securities for its own account. The individual partners of Lehman Brothers are directors of various industrial and banking corporations (R. 32a-33a).

One of the respondents, John Hertz, testified that he became a partner of Lehman Brothers in 1934 "to bring business" to that firm (R. 60a, 62a); shortly thereafter he "joined Tide Water (as a director) thinking it was going to be in the interest of Lehman Brothers" (R. 65a), and that his official connection with Tide Water "surely brought (the) Tide Water business to Lehman Brothers" (R. 62a).

Mr. Hertz further testified that shortly prior to his resignation as a director of Tide Water he had a discussion with his partner, Joseph A. Thomas, and "asked him whether he would like to go on the (Tide Water) Board." Upon receiving an affirmative answer, Mr. Hertz "spoke to the president of the Tide Water Company" and recommended that Mr. Thomas replace him as a director on its Board (R. 64a).

Mr. Hertz conceded that one of his reasons for recommending the appointment of Mr. Thomas as a director to the Tide Water Board was because he thought "it was going to be in the interest of Lehman Brothers" (R. 65a).

As a result of Mr. Hertz's recommendation, respondent, Joseph A. Thomas, was appointed to the Tide Water Board on August 5, 1954, the date Mr. Hertz's resignation therefrom became effective. Mr. Thomas has held that office since that time (R. 36a, 38a).

Upon the trial of the action petitioner made a full offer of proof to demonstrate that the appointment of Mr. Thomas to the Tide Water Board was in no sense fortuitous, but was the result of a well-defined, pre-conceived and calculated plan initiated and executed by respondent, Lehman Brothers, for the express purpose and design of furthering that firm's personal interests. The Court refused to allow such proof \* (R. 27a-31a; 88a-98a).

Respondents testified that it is the usual custom and practice of Lehman Brothers, prior to undertaking any financing or other business deals for a corporation, to discuss the matter with the particular partner of Lehman Brothers who is a director of the corporation involved "because he knows more about it" and "would be cognizant of what is going on" (R. 50a, 78a-79a).

10 After respondent, Joseph A. Thomas, had become a director of Tide Water, respondent, Lehman Brothers, participated in a \$50 million bond underwriting issue for Tide Water; Mr. Thomas was assigned by Lehman Brothers to represent its interests with respect to such financing (R. 42a, 76a-77a). Prior to that time, and while Mr. Hertz was a director of Tide Water, the respondent, Lehman Brothers, had on several occasions performed similar services for Tide Water and had received compensation therefor (R. 17a).

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\* The offer of proof consisted of petitioner's Notice to Admit and the respondents' answers thereto (R. 9a-21a), indicating a definitive plan by Lehman Brothers to perpetuate one or more of its partners upon the Boards of corporations with whom the firm was doing business. Pursuant to stipulation the respondents had reserved their rights to object to the relevancy and materiality of the items set forth in the Notice to Admit, and the Court sustained the respondents' objections thereto.

Respondent, John Hertz, testified that prior to his resignation as a director of Tide Water, "there were several discussions" among its Board members with respect to a plan for converting the Tide Water common shares into shares of \$1.20 dividend preferred stock and "a lot of different plans of financing the new (Tide Water) refinery" (R. 65a). Mr. Hertz admitted that he discussed these plans with his partners at Lehman Brothers in "a gossiping way," and further admitted that "we (Lehman Brothers) tried to advise the president (of Tide Water) to the best of our ability" with respect thereto. In response to a pointed question as to whether any of his partners at Lehman Brothers had asked his opinion "of Tide Water's management or its prospects," Mr. Hertz testified that "I probably gossiped about it" (R. 66a-67a).

Respondent, Joseph A. Thomas, testified that after he had become a director of Tide Water, several of his partners at Lehman Brothers asked for his opinion concerning Tide Water's management and policies and that he had expressed his opinions "freely" and had "suggested from time to time that I thought Tide Water under the new management was an attractive investment." Mr. Thomas further testified that one of such partners with whom he had the most extensive discussions concerning these matters was William J. Hammerslough, *who subsequently authorized Lehman Brothers' purchases of Tide Water common shares of stock* (R. 54a-56a; 70a).

Respondent, William J. Hammerslough, testified that "Thomas spoke very highly of the management and prospects of Tide Water Oil Company" and "thought very highly of it" (R. 69a). Mr. Hammerslough further testified that, prior to the time he authorized Lehman Brothers to purchase the Tide Water common stock, he had discussed the advisability of such purchases with some of his partners and they all felt "that this preferred stock

into which the common was going to be exchanged . . . would be a very, very safe, good investment, and would be attractive once it was issued, to institutional investors throughout the country" (R. 71a).

In the early part of September, 1954, subsequent to his appointment as a director, the respondent, Joseph A. Thomas, learned from another Tide Water director that the corporation was seriously considering a plan to permit certain of its stockholders to convert any or all of their common shares into shares of a contemplated new issue of \$1.20 dividend preferred stock (R. 46a).

On October 8, 1954, it was publicly announced that Tide Water's Board had approved a plan to create a \$1.20 dividend preferred stock and that its shareholders, other than three corporate stockholders owning in the aggregate 53 per cent of its common stock, "would have an opportunity to surrender all or any part of their common shares in exchange for the new preferred on a share-for-share basis" provided such plan were approved by the Tide Water stockholders at a meeting on November 15, 1954 (Defts. Ex. B; R. 163a, 75a).

Between October 8, 1954 and November 15, 1954, respondent, Lehman Brothers, purchased for its own account 50,000 shares of Tide Water common stock (R. 43a-44a). At the time these purchases were being effected, respondent, Thomas, was informed by his partners that Lehman Brothers was acquiring this common stock for the specific purpose of converting them into shares of \$1.20 Dividend preferred stock and then selling the preferred to institutional investors (R. 49a-50a).

On December 8, 1954, respondent, Lehman Brothers, converted the 50,000 shares of its Tide Water common

stock and received in exchange therefor 50,000 shares of Tide Water's newly created \$1.20 dividend preferred stock (R. 86a). The district court properly ruled that such acquisition by Lehman Brothers of the Tide Water preferred stock constituted a "purchase" thereof within the meaning and intent of Sections 3(a) (13) and 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sects. 78c (a) (13) and 78p (b); and that Lehman Brothers' cost of such preferred shares was "the lowest price at which Tide Water common stock was selling on the conversion date," namely, "\$25.25 per share" (R. 156a).

Between December 8, 1954 and March 8, 1955, respondent, Lehman Brothers, sold its 50,000 shares of Tide Water preferred stock for the net sum of \$1,361,186.77 (R. 87a).

The District Court found, after trial without a jury, that respondent, Lehman Brothers, had realized "short-swing" profits aggregating the sum of \$98,686.77 from its aforesaid transactions in the Tide Water preferred stock (R. 156a).

The Court dismissed the complaint as against respondent, Lehman Brothers, and entered judgment against respondent, Joseph A. Thomas, in the sum of only \$3,893.41 which represented the latter's *proportionate partnership share* of the total "short-swing" profits realized by respondent, Lehman Brothers, as aforesaid. The Court also refused to allow any interest upon such recovery (R. 155a-156a, 158a).

The United States Court of Appeals for the Second Circuit affirmed the judgment of the District Court (R. 174, 193) with a strong dissenting opinion by Judge Clark (R. 186).

Petitioner's motion to certify questions to the United States Supreme Court (R. 198a) was denied by the Court of Appeals—Judge Clark dissenting (R. 203a).

The motion made by the Securities and Exchange Commission for leave to participate *amicus curiae* and to file a petition for rehearing (R. 194), was denied by the Court of Appeals—Judge Clark dissenting (R. 196). Petitioner's application for rehearing *in banc* (R. 197) was denied by the Court of Appeals (R. 199), with a dissenting opinion by Judge Clark with which Judge Smith concurred (R. 199).

### Summary of Argument.

The stated Congressional purpose for the enactment of Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., 78p(b), was "preventing the unfair use of information which may have been obtained by such beneficial owner, director or officer by reason of his relationship to the issuer."

In attempting to foreclose the avenue of proven abuses to such "insiders" having access to corporate information not available to the general investing public, the method adopted by Congress to accomplish this result was to make the "insider" disgorge *all* the profits realized by him from his "short-swing" transactions in the issuer's securities "irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months."

In specifying three categories of those who clearly have access to inside corporate information, the Legislature at no time evinced any intention of limiting the statutory application to only those *literally* designated therein while completely exonerating others who demonstrably fall within its inhibitory ambit and similarly have access to and actually make use of inside information for their own selfish interests.



In construing Section 16(b) of the Act, the Courts have uniformly held the statute to be "broadly remedial"<sup>1</sup> and its purpose "to strike down *any means* by which insiders, because of their special knowledge of the affairs of the corporation or the plans of its board of directors, might realize for themselves a 'short-swing' profit, which would be denied the other stockholders or investing public, not enjoying such inside information."<sup>2</sup>

The close relationship between respondent, Thomas, and his partners, respondent, Lehman Brothers, was such as to constitute them collectively as "insiders" within the intent and meaning of the statute. The respondent, Lehman Brothers, acting as an entity, and having its firm interests represented upon Tide Water's Board by Mr. Thomas, had the same influence and access to confidential information as its partner who was at the same time a director of Tide Water. Indeed, the evidence in the record clearly indicates that such confidential information was actually imparted by Mr. Thomas to a number of his partners at Lehman Brothers and constituted the basis for that firm's subsequent purchases of Tide Water's common shares.

Although the legislative history and the statute itself indicates that Congress eliminated a "subjective standard of proof"<sup>3</sup> for applying the provisions of Section 16(b), the decision by the Court below in *Rattner v. Lehman* (C. A. 2), 193 F. 2d 564, which was followed in the case at bar, appears to make such "subjective proof" the criterion for any recovery against the partnership.

In view of the history and legislative purpose of Section 16(b), the courts have consistently applied an interpre-

<sup>1</sup> *Smolowe v. Delendo Corp.*, 2 C. A., 136 F. 2d 231, 239.

<sup>2</sup> *Kogan v. Schulte*, 61 F. Supp. 604, 608; *aff'd sub. nom.*; *Park & Tilford, Inc., v. Schulte*, 2 C. A., 160 F. 2d 984.

<sup>3</sup> See *Smolowe v. Delendo Corp.*, *supra*, p. 236; *Gratz v. Claughton* (C. A. 2), 187 F. 2d 46, 50, cert. denied, 341 U. S. 920.



tation to the statute in particular cases so as to fully effectuate the Congressional aims therefor. A notable exception to such uniform interpretation was made by the Second Circuit Court of Appeals in the instant case where, as Judge Clark noted, "the incentive to take insiders' profits is strongest as a part of a trading firm's normal business and where exception is the most difficult to understand" because of "the unfair discrimination it builds into an important remedial statute—a discrimination substantially eliminating the great Wall Street trading firms from the statute's operation."

Although Judge Medina, writing the majority opinion for the Court below, recognized that the legislative purpose of the statute requires that it be construed "to include the partnership because of the unity of the partnership relationship and the fact that one of the partners is a director," he felt "bound" to follow the Court's earlier decision in the *Rattner* case, *supra*.

In the *Rattner* case, *supra*, as here, the Court below refused to impose any liability upon the partnership which had realized the short-swing profits, while limiting the recovery from the partner-director to the latter's partnership interest in his firm's profits. The rationale for the Court's decision in that case was predicated upon a *literal* interpretation of Section 16(b) rather than upon a *broad* construction which would effectuate its legislative purpose.

However, even under any *literal* interpretation of the statute, since each partner is the "co-owner" of all partnership property, the partner-director should have been held accountable under the statute for *all* of his firm's short-swing profits unless the legal meaning of "owner," as used in Section 16(a) of the Act, is construed to exclude a "co-owner."

<sup>4</sup> *Blau v. Lehman* (C. A. 2), 286 F. 2d 786, 799; R. 187, 202, 203.

Although acknowledging that under the "broadly remedial" nature of Section 16(b), an interpretation requiring the partnership to pay back its short-swing profits would be "one way" to effectuate the legislative purpose of the statute, the Court below, nevertheless, refused to apply such construction, but, instead, chose to follow the *literal* statutory interpretation of its prior ruling in the *Rattner* case.

Turning to the partner-director, Thomas—the Court below found that since he had waived all rights to receive any part of his firm's short-swing profits, a *literal* application of the statute would obviously absolve him from any liability. Here too, as in the case of the partnership, the Court acknowledged that unless the provisions of Section 16(b) were applied to such partner-director, "we shall have opened a breach in the law through which stock-brokers and investment banking houses, those most likely to be in a position to profit by the use of confidential information in stock speculation, can pass with impunity."

Emphasizing that the legislative purpose of the statute required a construction which would impose liability upon the partner-director—although the same considerations were also present in the case of the partnership—the Court below granted a judgment against the respondent, Thomas, to only the *limited extent* of his partnership interest in his firm's short-swing profits. The Court further limited such recovery by refusing to allow any interest thereon.

This conscious limitation upon the partner-director's liability was apparently prompted by the Court's reliance upon its prior ruling to the same effect in the *Rattner* case, *supra*. However, the Court's reasons for limiting the partner-director's liability in *that* case found "further support in Rule X-16A-3(b) of the Securities and Exchange Commission which permitted a partner to file a report 'only as to that amount of such equity security which represents his *proportionate interest* in the partnership.'" 37

Shortly after the *Rattner* decision, the Commission amended its rule requiring the partner to report "*the entire amount* of such equity security owned by the partnership" (17 C.F.R. 240.16a-3(b); Append. p. 53). In view of such amendment of the rule, this ground, relied upon by the Court in the *Rattner* case, for limiting the partner-director's liability is no longer applicable. Indeed, the amended Rule would now seem to require a recovery from the partner-director of *all* the short-swing profits realized by the partnership.

The inconsistent standards of statutory interpretation which the Court below applied to the partnership, on the one hand, as against the partner-director, on the other, lends additional support to petitioner's argument that the fulfillment of the legislative purpose can only be accomplished if both the partnership and the partner-director are each held liable for *all* of the firm's short-swing profits.

Unless the statute is so construed as to hold ~~both the partnership and the partner-director~~ liable, jointly and severally, for *all* the "short-swing" profits realized by the *firm*, the stated Congressional purpose for its enactment will be defeated, and the doors will again be left wide open to indiscriminate stock manipulations, contrary to the public interest.

## ARGUMENT.

### I.

The congressional purpose and intent of Section 16(b) of the Securities Exchange Act of 1934 requires that respondent, Lehman Brothers, be held accountable for all short-swing profits realized by the firm.

Prior to the enactment of the Securities Exchange Act of 1934, Congress became aware of the fact that speculation in corporate stock by "insiders" of the companies involved was contrary to the public interest and was imperiling the economic structure of the United States.

The Congressional reasons for passage of the Act are fully and clearly set forth in Section 2 thereof.<sup>1</sup> In its purpose the Act "is aimed as an integrated entity toward the reform of the security markets by control of speculation and protection of the public against trading based on inside information and other abuses in the market machinery."<sup>2</sup>

The main purpose of the Act is to protect the millions of individual investors throughout the country who participate in the ownership of securities in public corporations. The Act seeks to ensure this great segment of the investing public that the securities exchanges which they use for the purchases and sales of corporate stock shall be maintained as fair, free and open markets, by prohibiting pool operations and other similar market manipulations, and by thwarting or punishing abuses of such market facilities. The Act is principally designed to prevent recurrence of abuses which contributed so greatly towards the stock market debacle of 1929.

<sup>1</sup> 15 U. S. C. A., Sec. 78(b).

<sup>2</sup> 46 Yale L. J. 624, 629; See also, *Smolowe v. Delendo Corp.*, DCSDNY, 36 F. Supp. 790, 791; *aff'd* (2 C. A.) 136 F. 2d 231; *cert. denied*, 320 U. S. 751.

The Securities Exchange Act of 1934 recognizes that the primary cause of investor impotence is the "insider's" ability to control his corporation's stock in utter disregard of his fiduciary responsibilities towards and the rights of the investors whom he is presumed to represent.

National securities exchanges have greatly aided in the diffusion of corporate ownership since they have furnished the machinery which enables investors throughout the land to instantly buy or sell securities traded on such markets. Unless such investors are assured of obtaining accurate and sufficient information upon which they can form an independent opinion as to the values of securities traded upon such exchanges, and unless such exchanges are conducted fairly, as free and open markets, the prices at which such securities were purchased and sold would be reduced to a game of chance.

The provisions of the Securities Exchange Act of 1934, as a whole, seeks to protect the rights of the investing public. Section 16(b)<sup>3</sup> is closely related to the rest of the Act by adding the means of guaranteeing to the investor that the information, which he is entitled to obtain under the Act, shall not be made useless to him by the manipulations of "insiders" who have had the opportunity of taking full advantage of such information prior to public release thereof.

More particularly, Section 16(b) of the Act creates in any corporation listed upon a national securities exchange, and in its stockholders, the right to recover from any "insider" of such corporation all the profits realized from his purchases and sales of the corporation's equity securities within a period of less than six months.

Section 16(b) of the Act was adopted after a long and comprehensive Congressional investigation which disclosed

<sup>3</sup> Appendix, *infra*, p. 51.

numerous instances where "insiders" took advantage of confidential information by trading in their issuer's securities prior to any public disclosure of such information.\* The Senate Committee on Banking and Currency, in its Report on Stock Exchange Practices, referring to Section 16(b), said:

"Among the most vicious practices unearthed at the hearings before the sub-committee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others."

Section 16(b) of the Act seeks to discourage such activities by providing that any profits realized by such "insiders" shall inure to the benefit of the corporation. Congress selected the corporation itself as the instrument to enforce this statutory policy but, recognizing that in most instances the corporation would be reluctant to sue its own directors, officers and large stockholders, the section provides that "if the issuer shall fail or refuse to bring such suit within sixty days after request, or shall fail diligently to prosecute the same thereafter," any security holder of the corporation may commence such action on its behalf.

The stated purpose of Section 16(b) is "preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer, by reason of

\* Senate Report No. 1455, 73d Cong., 2d Sess. (1934), pp. 55-68. See *Loas, Securities Regulation* (1951), pp. 561-98.

† Senate Report No. 1455, 73d Cong. 2d Sess. (1934), p. 55.

his relationship to the issuer." Congress thus attempted to close the avenue of proven abuses by "insiders" having access to corporate information which was not then available to the investing public.

In its effect Section 16(b) "was but a new approach to the common law attitude which had long recognized the reasonableness of enforcing a level of conduct upon fiduciaries 'higher than that trodden by the crowd.'" *Smolowe v. Delendo Corp.* (2 C. A.), 136 F. 2d 231, 239, cert. denied 320 U. S. 751.

Recovery under Section 16(b) is predicated upon an objective measure of proof and does not require any showing that the "insider" actually obtained confidential information or used it for his own benefit. As the Court stated in *Smolowe v. Delendo Corp.*, *supra*, at page 236:

"Had Congress intended that only profits from an actual misuse of inside information should be recoverable, it would have been simple enough to say so. Significantly, however, it makes recoverable the profit from any purchase and sale, or sale and purchase within the period. The failure to limit the recovery to profits gained from misuse of information justifies the conclusion that the preamble was inserted for other purposes than as a restriction on the scope of the act. \* \* \*"

And in *Gratz v. Claghton* (2 C. A.), 187 F. 2d 46, 50, cert. denied 341 U. S. 920, in affirming a judgment against a defendant in a Section 16(b) action, the Court said:

"\* \* \* If only those persons were liable who could be proved to have a bargaining advantage, the execution of the statute would be so encumbered as to defeat its whole purpose. We do not mean that the interest, of which a statute deprives an individual, may never be so vital that he must not be given a trial of his personal guilt; but that is not so when all that is at stake is a director's officer's or 'beneficial owner's' privilege to



add to, or subtract from, his holdings for a period of six months. In such situations it is well settled that a statute may provide any means which can reasonably be thought necessary to deal with the evil, *even though it may cover instances where it is not present.* \* \* \* (Italics supplied.)

It is quite clear that the statute is wholly unconcerned with either the fairness of a particular transaction or the "insider's" good faith or good intentions in effecting it. Its principal purpose is to *deter* the "insider" from purchasing and selling his listed issuer's securities within a period of less than six months by causing him to surrender all profits which he may have realized from such transactions.\*

In the course of the Congressional hearings, one of the draftsmen of the Act testified that Section 16(b) is designed to reach an "insider's" short-swing profits "irrespective of any intention or expectation to sell the security within six months," since it is "absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended at the time he bought, to get out on the short-swing."

Section 16(b) of the Act as finally passed by the Congress provides that the liabilities imposed thereunder shall be enforced "irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months."

\* *Grossman v. Young* (DCSDNY), 70 F. Supp. 970, 971, 972; *Carr Consolidated Biscuit Co. v. Moore* (DCMD Pa.), 125 F. Supp. 423, 427; *Stella v. Graham Paige Motors Corp.* (C. A. 2), 232 F. 2d 299, 302.

† Hearings before the Senate Committee on Banking and Currency on S. 84, 73rd Cong., 1st Sess. (1934), p. 6557.

It is thus quite evident from the legislative history of Section 16(b) and the final form of the statute itself that, in a sense, the provisions stated therein merely reiterate the specific application of the time-honored principle that a fiduciary may engage in no activity which may, by even a remote possibility, involve a conflict of interest between his official duties and his private interests. *Michaud v. Girod*, 4 How. 503, 559; *Magruder v. Drury*, 235 U. S. 106; *Pepper v. Litton*, 308 U. S. 295.

In their interpretations of this section of the Act, the Courts have consistently sought to close all avenues leading to any possible evasion of its provisions (*Smolowe v. Delendo Corp.*, *supra*), so as "to carry out in particular cases the generally expressed legislative policy,"<sup>8</sup> by striking down "*any means* by which insiders, because of their special knowledge of the affairs of the corporation or the plans of its board of directors might realize for themselves a 'short-swing' profit, which would be denied the other stockholders or investing public not enjoying such inside information."<sup>9</sup>

A singularly important exception to such consistent interpretation of the statute has been made by the United States Court of Appeals for the Second Circuit in the case of an investment partnership firm which has realized profits from its short-swing transactions in the securities of a listed corporation upon whose Board one of the firm's partners is a director. The Court has refused to hold the *partnership firm* liable for any of the short-swing profits realized by it, while limiting the recovery from the *partner-director* to only his proportionate partnership interest therein.<sup>10</sup>

<sup>8</sup> *Securities and Exchange Commission v. C. M. Joiner Leasing Corp.*, 320 U. S. 344, 350, 351.

<sup>9</sup> *Kogan v. Schulte* (DCSDNY), 61 F. Supp. 604, 608, *aff'd sub. nom.*; *Park & Tilford, Inc., v. Schulte* (C. A. 2), 160 F. 2d 984, cert. denied, 332 U. S. 761.

<sup>10</sup> *Rattner v. Lehman* (C. A. 2), 193 F. 2d 564; *Blau v. Lehman* (C. A. 2), 286 F. 2d 786, cert. granted, 81 S. Ct. 1048.

The anomaly in thus departing from its own expressed and accepted standards for interpreting the legislative intent and purpose of the statute led Judge Clark to remark in his dissenting opinions below that the majority of the Court has *judicially* exempted an investment partnership firm from any liability "in the very case where the incentive to take insiders' profits is strongest as a part of a trading firm's normal business," and that "the most serious vice" of the court's decision "is the unfair discrimination it builds into an important remedial statute—a discrimination substantially eliminating the great Wall Street trading firms from the statute's operation."<sup>11</sup>

Although Judge Medina, writing the majority opinion for the Court below in the case at bar, recognized that "there is only one way to prevent stock manipulation by insiders to whom confidential information is available," and that is "to construe Section 16(b) to include the partnership because of the unity of the partnership relationship and the fact that one of the partners is a director," he, nevertheless, insisted upon following the Court's prior decision in *Rattner v. Lehman* (C. A. 2), 193 F. 2d 564.<sup>12</sup>

The principal reason relied upon by the Court below in the *Rattner* case, *supra*, for absolving the partnership from any liability under the statute, while limiting the partner-director's liability thereunder, was its *literal* interpretation of Section 16(b), which provides for the issuer's right to recover from a director "any (short-swing) profits realized by him." By restricting the application of the statute to its *literal* interpretation, the Court, in effect, repudiated its prior decisions which had emphasized repeatedly that Section 16(b) must be construed broadly so as to effectuate its legislative purpose. Moreover, even upon such a *literal* interpretation of the statute, since each

<sup>11</sup> *Blau v. Lehman*, *supra*, pp. 793, 799; R. 187, 202, 203.

<sup>12</sup> *Blau v. Lehman*, *supra*, p. 791; R. 182.

partner is "co-owner" of all property purchased with partnership funds and has an equal right with his other partners to possession therein, the elimination of any recovery of the full partnership liability can only be sanctioned if the legal meaning of "owner" in Section 16(a) of the Act is construed to exclude a "co-owner."

Although the *results* reached by the Court below in the instant case were identical to those in the *Rattner* case, *supra*, the different standards applied for interpreting Section 16(b) were so inconsistent and contradictory as to be irreconcilable.

In its majority opinion, the Court below expressly acknowledged that since Section 16(b) is a "broadly remedial statute," the application of its provisions requires a *broad* interpretation to effectuate its legislative purpose; that an interpretation of the statute which holds the partnership liable thereunder is "one way to do this." The Court then proceeded to wholly disregard its own recognized standards of broad statutory application by *absolving* the partnership from any liability whatsoever. In arriving at such an inconsistent result, the Court stated that it felt "bound" by its prior ruling in the *Rattner* case, *supra*, which was predicated upon a *literal* interpretation of Section 16(b).

The inconsistent standards, which the Court below applied in its interpretations of the statute, becomes even more pronounced in view of its exceptional treatment of the partner-director's liability.

Since the partner-director, Thomas, had waived his right to share in the short-swing profits realized by the partnership, any *literal* interpretation of the statute obviously would have absolved him from any liability thereunder. Recognizing, however, that any such *literal* application of the statute would flout its legislative purpose, the Court below concededly interpreted the provisions of Section

16(b) "*broadly*" and imposed the statutory liability upon the partner-director. Refusing to continue its broad application of the statute with respect to the *amount* of such partner-director's liability thereunder, and insisting, in this phase of the case, upon following the *literal* interpretation accorded to the statute in the *Rattner* case, —although the fruition of the legislative purpose, in this instance, equally required a broad statutory application—the Court expressly *limited* the partner-director's liability to only his proportionate partnership interest in his firm's short-swing profits.

## II.

The respondent, Lehman Brothers, was an "insider" of Tide Water within the meaning and intent of Section 16(b) of the Act and, therefore, was liable for all short-swing profits realized from its transactions in Tide Water's preferred stock.

**A. The respondent, Lehman Brothers, deputed its partners to represent its interests on the Tide Water Board.**

The record clearly demonstrates that Lehman Brothers deputed its partners to represent the firm's interests as directors on Tide Water's Board.

The sequence of events first indicating any association or connection between Lehman Brothers and Tide Water goes back to the year 1934 when Mr. John Hertz, one of Lehman Brothers partners, was first elected to the Tide Water Board. Mr. Hertz continued being a member of Tide Water's Board from that date until August 5, 1954, when his resignation therefrom became effective.

Mr. Hertz candidly testified (R. 62a) that "I came here (to Lehman Brothers) to bring business to Lehman Brothers, and I devoted my time to it, \* \* \*."

In response to a question as to whether his being a director of Tide Water brought any business to Lehman Brothers, Mr. Hertz responded (R. 62a):

"I am sure it did. It surely brought Tide Water business."

The following testimony by Mr. Hertz is irrefutable proof that he joined Tide Water's Board as a director for the sole purpose of representing and fostering Lehman Brothers interests (R. 65a).


"Q. Is it the practice of Lehman Brothers to have some of its partners go on boards of corporations in order to further the interests of Lehman Brothers? A. Well, I surely joined Tide Water Company thinking it was going to be in the interests of Lehman Brothers."

Mr. Hertz admitted that during his tenure as a director of Tide Water he "gossiped" about its affairs with his partners at Lehman Brothers (R. 63a).

The only logical inference to be drawn from the aforesaid facts is that Mr. Hertz *literally* represented the interests of Lehman Brothers as a director on Tide Water's Board.

The record conclusively demonstrates that the continuity of Lehman Brothers representation upon Tide Water's Board remained unbroken even after Mr. Hertz had resigned as a director.

A short time prior to his resignation, Mr. Hertz spoke to his partner, respondent, Joseph A. Thomas, and "asked him whether he would like to go on the board, and he (Thomas) said he would." Mr. Hertz thereupon "spoke to the president of the Tide Water Company" and recom-





mended that Mr. Thomas replace him (Hertz) as a director. Pursuant to such recommendation, Mr. Thomas was appointed to the Tide Water Board on August 5, 1954, the date Mr. Hertz's resignation became effective (R. 64a).

Mr. Hertz honestly admitted that his chief purpose in recommending Mr. Thomas as a Tide Water director was to further the interests of Lehman Brothers by such representation (R. 65a).

It is traditional partnership law that "Every partner is an agent of the partnership for the purpose of its business." See New York Partnership Law, Section 20.

Legally, therefore, Mr. Hertz's recommendation that Mr. Thomas be appointed to the Tide Water Board actually represented *the act of the partnership firm of Lehman Brothers*; the *firm itself* deputed Mr. Thomas to become a member of the Tide Water Board so that the partner-director would represent and foster the firm's interests thereby. How well this succeeded will hereinafter be discussed more fully.

Petitioner offered proof at the trial that the designation and appointment of Mr. Thomas as a Tide Water director was in no sense fortuitous but represented a preconceived plan and design which had been followed by Lehman Brothers consistently throughout the years not only as respects Tide Water but numerous other corporations as well.

Thus, Mr. Monroe C. Gutman, one of Lehman Brothers partners, testified that "There are times when it has been suggested" by the firm that its members be appointed as directors of various corporations (R. 79a). Mr. Gutman further testified that where Lehman Brothers does any business with a corporation upon whose board one of his partners is a director, this particular partner-director



"would be one of those who would be consulted" by Lehman Brothers "because he would be cognizant of what is going on" (R. 78a).

The record is crystal clear that Joseph A. Thomas, the partner-director on Tide Water's Board, was, indeed, "consulted" by Lehman Brothers prior to that firm's "short-swing" transactions in the Tide Water stock. Mr. Thomas testified that after he had become a director, certain members of his partnership firm, *including Mr. Hammerslough, the firm's partner who actually authorized its purchases of Tide Water stock*, discussed the policies, management and prospects of the corporation with him and Mr. Thomas "suggested" that "Tide Water under the new management was an attractive investment" (R. 54a-56a). Mr. Hammerslough also testified "that Thomas spoke very highly of the management and prospects of the Tide Water Oil Company" and "thought very highly of it" (R. 69a).

In order to further demonstrate that Mr. Thomas' appointment as a director to Tide Water's Board was initiated by Lehman Brothers pursuant to a definitive plan to have Mr. Thomas represent the firm's interests thereon, petitioner attempted to read into evidence the respondents' answers to a Notice to Admit which indicated a systematic plan to perpetuate various partners of Lehman Brothers as directors in at least ten (10) different corporations taken at random with whom the partnership was doing business (R. 9a-21a).

The Trial Court refused to allow these facts to be introduced into evidence ruling them "irrelevant." Petitioner thereupon made a full offer of proof with respect thereto (R. 87a-98a).

In *United States v. Morgan, et al.* (DCSDNY), 118 F. Supp. 621, the Court found as a fact that it was the

policy of Lehman Brothers to place its partners or employees on the boards of various corporations to obtain and hold business, stating (p. 715):

“ . . . It was a matter of policy with them (*Lehman Brothers* and *Goldman Sachs*) to place partners or employees on the boards of directors of issuers, and there is evidence that they each used the presence of such men on these boards in various ways in support of their competitive efforts, partly to get business but principally to hold on to such business, once it had been secured.”

The case of *Lehman, et al., v. Civil Aeronautics Board*, 209 F. 2d 289, cert. denied 74 S. Ct. 513, is peculiarly pertinent to the issues here involved. In that case the facts were as follows:

Under Section 409(a) of the Civil Aeronautic Act of 1938, it is unlawful for an air carrier to have as a director one who is also a director of a common carrier unless the particular relationship is approved by the Civil Aeronautical Board (herein referred to as CAB), upon a showing that the public interest will not be adversely affected.

A number of Lehman Brothers partners were directors of different corporations engaged as common carriers. CAB instituted proceedings to determine whether any of the members of the Lehman Brothers partnership who served as directors in any phase of aeronautics were or might be “representatives” of other partners who were directors of other such corporations.

CAB disapproved the membership of various Lehman Brothers partners as directors of different carriers upon the ground that “whenever the partner’s acts as a director might further the interest of the partnership in accordance with the intended purposes of the firm in performing such acts, it must be concluded that the partner represents the firm.”

In affirming the decision of the CAB, the Court of Appeals said (pp. 292-294):

"Petitioner, Lehman, is a director of Pan American; petitioner, Joseph A. Thomas, is a director of National Airlines, Inc. and of American Export Lines, Inc.; petitioner, Frederick L. Ehrman, is a director of Continental Air Lines, Inc., and Mr. John D. Hertz is a director of Consolidated Vultee Aircraft Corporation. All the companies referred to are in the aeronautic field and so must have Board approval of the kind of interlocking relationships which are made unlawful unless approved. Messrs. Lehman, Thomas, Ehrman, Hertz and others, are also members of Lehman Brothers, a partnership which, as previously pointed out, conducts an investment banking business.

"The Board held that an individual Lehman Brothers partner who is a director of a Sect. 409(a) Company is a representative of another partner who is a director of another such company. The relationships thus found to exist were disapproved.  
• • •

"More precisely the Board concluded that a Lehman Brothers partner who is a director of an air carrier has a representative 'who represents such • • • director as • • • a director' in another Sect. 409(a) company if another Lehman Brothers Partner is a director of the latter, coupled with the circumstances that he seeks on behalf of Lehman Brothers the security underwriting and merger negotiation services used by the Company of which he is director. *The underwriting of security issues and the conduct of merger negotiations constitute a substantial part of the business of Lehman Brothers, who have been employed for these purposes not infrequently by Sect. 409(a) companies. The partners feel free to select this business for their firm.*

"*The underwriting activities of Lehman Brothers is a substantial part of its business; substantial fees are also obtained by Lehman Brothers from merger negotiations. Profits from the fees are*

shared by the partners. Sect. 409(a) companies, with Lehman Brothers partners as directors, need to use both type of services, and the partner directors seek such business for the partnership. In doing so they act as representatives of the partnership. It follows that they act as representatives of fellow partners, some of whom are directors of air carriers. \* \* \* Does Mr. Thomas, to use his case as illustrative, who is a Lehman Brothers partner and also a director of National Airlines, represent, as a director of National Airlines, Mr. Lehman, another Lehman Brothers partner and director of Pan American? We think that the affirmative answer of the Board should not be disturbed. For the situation comes to more than some community of interest and some sharing of common benefits as partners. The partnership link does not extend merely to a type of business remote from the aeronautical industry in which the partners are directors. \* \* \* In these activities there is not only literal representation by one partner of another in partnership business but the particular partnership business is as well the business of aeronautical enterprises of which the partners are directors. When Mr. Thomas, again to illustrate, as director of National seeks to guide that company's underwriting business to Lehman Brothers he acts in the interest and for the benefit of Mr. Lehman who is not only his underwriting partner but is also a director of an air carrier, Pan American. *Mr. Lehman the partner is the same Mr. Lehman the director.* The Board is not required to separate him into two personalities, as it were, and to say that Mr. Thomas represents him as a partner but not as a director. \* \* \*. *The undoubted representation which grows out of the partnership we think follows into directorships when the transactions engaged in are not only by the partners but concern companies regulated by the statute of which the partners are directors. This is representation within not only the language but the meaning of the statute.*" (Italics supplied.)

A discussion of the *Lehman* case, *supra*, highlights the rationale of the Court's opinion in 42 *Georgetown L. J.* 141, 143, in the following fashion:

"The Court in the instant case, however does not derive its interpretation solely from the partnership relationship. The majority opinion states that partners would not be considered representatives of one another if they were members of 'a partnership which owns a *drug store*.' The additional element which enables them to find that in this case one partner is the representative of another is the fact that *Lehman Brothers engages in extensive underwriting and merger negotiation business and 'the partner directors seeks such business for the partnership.'* From this they conclude that an element of representation exists. \* \* \*." (Italics supplied.)

Apart from a judicial determination by the Court in *Lehman, et al., v. Civil Aeronautics Board, supra*, that "The underwriting activities of Lehman Brothers is a substantial part of its business" and that "the partner directors seek such business for the partnership" and "so they act as representatives of the partnership"—*these facts were independently proven in the instant case.* Mr. Thomas testified that the defendant, Lehman Brothers, was in the business of "Investment banking, generally" (R. 32a). Mr. Gutman, another partner of Lehman Brothers, testified as follows (R. 76a-77a):

"Q. Has your firm had any business dealings with Tide Water Associated Oil Company? A. I think they participated in an issue for the Tide Water Oil Company some time in the last year or so. I don't know exactly when it was.

"Q. Prior to this past year have you had any business dealings with Tide Water? A. In the past we did some financing for them, I believe."

• • • • •  
 "Q. Who in your organization was assigned to the Tide Water financing business? A. In Tide

Water financing business, it was done by Mr. Thomas. I think he was assisted by some of the staff. He probably had assistance from other partners, too. I don't know the details. As a rule, he is apt to have.

"Q. Did he discuss these matters with the other partners? A. I don't remember the details, Mr. Levy, but I am sure, before undertaking a commitment for the firm to do public financing, it was discussed at a partners' meeting. Frankly, I don't remember that discussion, but I think it probably was."

It requires no further elaborate argument to see that in attempting to obtain the Tide Water business for his firm, Mr. Thomas, the partner-director, was actually actively representing the interests of Lehman Brothers on Tide Water's Board. The record is clear that Mr. Thomas was deputed by Lehman Brothers to represent its interest on the Tide Water Board and that he performed this job very well.

**B. The respondent, Lehman Brothers, was a "insider" of Tide Water within the meaning and intent of Section 16(b), and, therefore, subject to its provisions.**

Since the respondent, Lehman Brothers, deputed its partner, Joseph A. Thomas, to represent the firm's interests on Tide Water's Board, the partnership itself was an "insider" of Tide Water within the meaning and intent of Section 16(b) of the Act and must account for all short-swing profits realized by it.

While it is true that Section 16(b) of the Act does not by its express language provide that a partnership shall be liable for the profits realized from its short-swing transactions in the securities of a corporation upon whose Board one of its partners is a member—the very nature



and business of the partnership relationship naturally contemplates such a result for the fulfillment of its Congressional purpose.

It is a well settled principle of law that a trustee's firm may not benefit from transactions with the trust.

Thus in *In re Los Angeles Lumber Products Co.* (DCSD Calif.), 37 F. Supp. 708, an analagous situation to the case at bar arose under Section 249 of the Bankruptcy Act which provides that "No compensation or reimbursement shall be allowed to any . . . attorney . . . who has purchased or sold . . . stock (of the debtor)."

A firm of attorneys traded in the bonds of the debtor despite the participation in the reorganization proceedings of one of the partners of the firm. In denying compensation to the *firm* the Court said (p. 711):

"It is contended here that, although Mr. Faries may be barred from compensation, the firm of which he is a member is in a different position. We must then decide whether or not those partners who were ignorant of Mr. Faries' bond transactions—if, indeed, there were any such partners—or those partners who did not participate in the transactions, should be permitted to receive any share of the compensation to which the firm would normally be entitled. The court feels in a situation such as this, each member of a law firm should share the responsibility for the individual acts of another partner or other partners. To construe Section 249 otherwise would largely destroy its effectiveness. *The relationship between partners is too close to make it possible to insure that compensation allowed to an innocent partner may not ultimately benefit a guilty partner, directly or indirectly. If Section 249 were to be construed as suggested, it might be possible to work out evasions of its provisions whereby one partner traded*



*while another did legal work. Such a situation would be intolerable. See Tracy v. Willys Corporation, 6 Cir. 1930, 45 F. 2d 485.*" (Italics supplied.)

In recognizing that "Large areas of 'insider' conduct were consciously left untouched by Congress for reasons dictated by practicalities rather than ethics or pure logic," and that Section 16(b) must be interpreted to fully carry out the purposes intended for it by Congress, the Court stated the following in *Adler v. Klawans* (C. A. 2), 267 F. 2d 840, 844-845:

"At most our task is, in Judge Cardozo's words, that of filling 'the open spaces in the law.' In addition to the intent and purpose of the legislation which we must glean from the statute as a whole rather than from isolated parts, we must consider the results which would flow from each of the two interpretations contended for. *If we find one interpretation tends to carry out and the other to defeat the purposes of the statute, the resolution of the issues becomes simple.*

"The undoubted Congressional intent in the enactment of Section 16(b) was to discourage what was reasonably thought to be a widespread abuse of a fiduciary relationship . . .

"Large areas of 'insider' conduct were consciously left untouched by Congress for reasons dictated by practicalities rather than ethics or pure logic. A line had to be drawn somewhere by the lawmakers as they must do in the laws of marriage, divorce, legitimacy, real estate, wills and a host of other subjects governed by statute. *But the consciously limited scope of the statute is no reason for us to seek yet further limitations of what is remedial legislation.*" (Italics supplied.)

In *Stella v. Graham-Paige Motors Corp.* (C. A. 2), 232 F. 2d 299, cert. denied, 352 U. S. 831, the Court affirmed the judgment of the district court which held that the purchase of securities which made a person a 10% stockholder

must be *included* in the short-swing transaction notwithstanding the express provisions set forth in Section 16(b) of the Act,<sup>13</sup> because such interpretation of the statute would truly effectuate the Congressional purpose and not defeat it. The opinion of the district court in the *Stella* case, *supra* (104 F. Supp. 957, 959), clearly demonstrates the logical reasons for such an interpretation in the following language:

"The purpose of Congress is a dominant factor in the determination of a statute's meaning. *United States v. C. I. O.*, 1948, 335 U. S. 106, 112, 68 S. Ct. 1349, 92 L. Ed. 1849, and where a choice may be made between two possible constructions, that construction should be chosen which would serve to effectuate Congressional purpose rather than defeat it. 'However well (rules of statutory interpretation) may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permit *so as to carry out in particular cases the generally expressed legislative policy.*' *Securities and Exchange Commission v. C. M. Joiner Leasing Corp.*, 1943, 320 U. S. 344, 350-351, 64 S. Ct. 120, 123, 88 L. Ed. 88." (Italics supplied.)

In *Colby v. Klune* (C. A. 2), 178 F. 2d 872, the Court was called upon to decide whether an *employee* performing important duties for his issuer, *but who was neither a legally designated director nor officer thereof*, could be held legally accountable for "short-swing" profits realized by him, solely because "he would be likely, in discharging these duties, to obtain confidential information about the

<sup>13</sup> The last sentence of Section 16(b) provides that "This subsection shall not be construed to cover any transaction where such beneficial owner (10% stockholders) was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, \* \* \*."

company's affairs that would aid him if engaged in personal market transactions." In reversing the District Court's dismissal of the complaint and remanding the matter for further proof, the Court said (p. 873):

"\* \* \* we construe 'officer,' as used in Section 16(b) of the Securities Exchange Act, thus: It includes *inter alia*, a corporate employee performing important executive duties of such character that he would be likely, in discharging these duties, to obtain confidential information about the company's affairs that would aid him if engaged in personal market transactions. It is immaterial how the functions are labelled or how defined in the by-laws, or that he does or does not act under the supervision of some other corporate representative. \* \* \*

It is obvious that Congress never intended the term "director," as used in Section 16(b) of the Act, to be construed in a narrow, ~~limited and literal~~ manner. Significantly, Congress expanded the definition in a broad, unrestricted sense to fully accomplish the purposes of the statute. Section 3(a) (7) of the Act, 15 U. S. C. A. Sect. 78c (a) (7), specifically provides as follows:

"The term 'director' means any director of a corporation or *any person performing similar functions* with respect to any organization, whether incorporated or unincorporated." (Italics supplied.)

That the term "person" as used in the aforesaid Section encompasses a partnership such as the defendant, Lehman Brothers, is specifically set out in Section 3(a) (9) of the Act, 15 U. S. C. A. Sect. 78c (a) (9), which provides as follows:

"The term 'person' means \* \* \* a partnership, \* \* \*"

As this Court stated in *United States v. A & P Trucking Co.*, 79 S. Ct. 203, 358 U. S. 121, at page 206, Note 3:

"Congress has specifically included partnerships within the definition of 'person' in a large number of regulatory Acts, thus showing its intent to treat partnerships as entities. \* \* \*

The close relationship between Joseph A. Thomas and his partners was such as to constitute them collectively a "person" within the meaning of the foregoing section. The defendant, Lehman Brothers, acting as an entity, and having its firm interests represented on the Tide Water Board by its partner-director Mr. Thomas, had the same influence and access to confidential information as the *legally designated* director of the corporation. The partnership, therefore, was a "director" of Tide Water within the meaning and intent of Section 16(b) and subject to its provisions.

The record demonstrates beyond peradventure that the purchases by Lehman Brothers of Tide Water common stock, its subsequent conversions into preferred shares and sales thereof within a six-month period, were predicated upon information concerning the affairs of Tide Water which had been imparted to Lehman Brothers by its partner-director, Mr. Thomas.

Mr. Hammerslough, one of the partners of Lehman Brothers, testified that he and two other partners were the "formal members" of the firm's Portfolio Committee and that "all other partners were invited at times to attend the meetings." Mr. Hammerslough further testified that he personally authorized the purchases by his firm of Tide Water common stock *after* he had fully discussed the matter with his partners, and they had concluded "that this preferred stock into which the common was going to be exchanged \* \* \* would be a very, very safe, good investment, and would be attractive, once it was issued, to institutional investors throughout the country." Mr. Hammerslough further testified that he had several discussions concerning the affairs of Tide

Water with Mr. Thomas after the latter had become a director of the corporation and "that Thomas spoke very highly of the management and prospects of the Tide Water Oil Company" and "thought very highly of it" (R. 69a-71a).

It is even more significantly evident, in the light of Mr. Thomas' testimony, that the decision of Lehman Brothers to purchase Tide Water common stock for the purpose of converting it into preferred shares and then selling the latter stock was wholly predicated upon the facts and opinions of Tide Water's affairs which Mr. Thomas disclosed to at least six (6) of his partners in the firm, including Mr. Hammerslough. Mr. Thomas testified as follows (R. 54a-56a):

"Q. You have been asked by certain members of your firm what you thought of (Tide Water) management? A. Yes.

"Q. And what you thought of the policies that they were formulating? A. That is right.

"Q. And what your opinions were concerning the effect they would have upon the business? A. That question I can't answer.

"Q. Can't? A. Can't. I have answered in the affirmative that I have said that I thought the management was good and I thought their general objectives were first-rate.

"Q. Can you recall with whom you had those conversations? A. No, I can't.

"Q. Was it with one or more of your partners? A. It might have been.

"Q. Mr. Gutman? A. Mr. Gutman I would unquestionably have discussed it, because he is very much interested in the oil business, generally speaking.

"Q. How about Mr. Hammerslough? A. Yes, I have talked to Bill from time to time about it.

"Q. Mr. Callery? A. Yes, I should have mentioned Mr. Callery. Mr. Callery is very knowledgeable of the oil business. I should have mentioned him before.

"Q. Mr. Fell? A. Yes.

"Q. Mr. Kennedy? A. Yes.

"Q. Mr. Manheim, Frank or Paul? A. Paul, yes; Frank, no.

"Q. With whom do you say you had most extensive conversations concerning these matters? A. Gutman, Hammerslough and Kennedy.

"Q. Were these gentlemen members of the committee of Lehman Brothers as you mentioned who selected various investment portfolios for Lehman Brothers? A. Kennedy certainly not. Mr. Gutman was at one time, and Mr. Hammerslough I think has been a member of the portfolio committee right along.

"Q. Did you at any time discuss with any of these gentlemen the advisability of your firm, Lehman Brothers, purchasing stock in Tide Water? A. No, not as a firm investment. I have suggested from time to time that I thought Tide Water under the new management was an attractive investment.

"Q. You had suggested that to— A. Not only to individuals of my own firm but to a great many people on the outside, because that is my belief.

"Q. But you had suggested that to members of your firm and told them that it would be a good investment for them? A. When the new management came in, *my opinion was asked of what I thought of it*, and after I watched them in, I expressed my opinion freely that I thought the management was first-rate, that the company would do well under that management.

"Q. Who asked your opinion concerning that? A. Some of the gentlemen that you mentioned."



In his dissenting opinion in the Court below Judge Clark aptly pointed out that "Unless judges are to be incredibly naive as to the facts of financial life, it is difficult to see what Thomas needed to say more to show that the lily was already gilded."<sup>14</sup>

A subdivision of Section 16 of the Act, as originally proposed, made it unlawful for an "insider" to disclose confidential information to another person and provided for the recovery of "short-swing" profits from the person to whom such information was disclosed. See *Hearings before Senate Committee on Banking and Currency in S. Res. 84, 72d Cong. 2d Sess. and S. Res. 56 and 97, 73d Cong., 1st and 2d Sess. (1934)*, page 6560; *Hearings before House Committee on Interstate Commerce & Foreign Commerce on H. Res. 7852 and 8720, 73 Cong. 2d Sess. (1934)*, pages 135-137.

Section 16(b), as finally adopted, omitted this provision because of the doubt as to its administrative practicability. As the Court said in *Smolowe v. Delendo Corp.*, C. A. 2, *supra* (p. 236):

"\* \* \* Furthermore, provisions in the early drafts, declaring unlawful the improper disclosure of confidential information regarding securities by directors, officers or principal stockholders, and holding that any profit made by any person to whom such unlawful disclosure was made should inure to the corporate issuer, were deleted, presumably because the burden of proof made enforcement unfeasible."

Recovery under Section 16(b) does not require any showing that the director or officer actually obtained confidential information by reason of his opinion, or utilized such information.

<sup>14</sup> *Blau v. Lehman*, *supra*, p. 795; R. 190.



Where, however, a partner-director *does* impart such inside information to his firm which might tempt it to engage in short-swing trading, unless the *entire* short-swing profits are recoverable *jointly and severally* from the director-partner and his firm, there would be absolutely no deterrent for the partner-director to pass on such inside information to his firm *for the mutual profit of all the members therein*.

Respondent, Lehman Brothers, has contended that it is not liable for the short-swing profits realized from its transactions in the Tide Water stock because the firm was not a literally designated director or officer of the corporation.

If its contentions were sustained under the peculiar facts of this case, emasculation of the Act would completely nullify its declared prophylactic purpose, and evasion of the provisions of Section 16(b) would be relatively simple. The respondent, Lehman Brothers, could under such circumstances engage with impunity in short-swing transactions in the numerous corporations upon whose Boards one of its partners is a director, reaping short-swing profits from stock transactions predicated upon confidential information disclosed to the firm by the partner-director who actually represented the *firm's* interests. The only penalty, according to Lehman Brothers' reasoning, should be against the partner-director alone, and it should be *limited* solely to *his* proportionate partnership interest.

It may reasonably be assumed that the partnership would not allow the particular partner-director to sustain a personal financial loss while the firm reaped the benefits from its member's beneficent activities on its behalf. The partnership undoubtedly would feel morally obligated at least to reimburse such partner and would find *some* way to accomplish this result.

Mutual "back-scratching" by the individual partners would redound to the partnership coffers and eventually find its way back to that particular partner-director whose activities on its behalf directly benefited the firm.

Indeed, apart from any such *moral* obligation, it would appear that the partnership is *legally* obligated to reimburse such partner-director. Thus, *Section 40 of the New York Partnership Law*, in so far as is here material, provides as follows:

"2. A partnership must indemnify every partner in respect of payments made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business, or for the preservation of its business or property."

*Section 24 of the New York Partnership Law* provides that:

"Where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership, or with the authority of his co-partners, . . . any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act."

It is traditional partnership law that each partner has an undivided interest in the *entire profits* realized by his firm, and is jointly and severally liable for anything chargeable to it. See *Section 26 of the New York Partnership Law*.

These legal concepts are even more applicable to the liability created by Section 16(b) of the Act since its asserted purpose, evincing a definitive public policy, is "preventing the unfair use of (inside) information."

Accordingly, the only way to foreclose all possible avenues for evading the statute and truly effectuating its intended purpose is to hold the *partnership*, Lehman Brothers, liable for *all* profits realized by it from its short-

swing transactions in an issuer's securities where one of its partners is a director of such issuer and has been deputed to represent the firm's interests on the issuer's Board.

This has been judicially recognized in *Rattner v. Lehman*, C. A. 2, 193 F. 2d 564, in an opinion written by Judge Learned Hand, as follows (p. 566):

" \* \* \* Therefore, I think we may dispose of the appeal on the assumption that Lehman Brothers bought and sold the shares without any advice or concurrence by Hertz; and the only question is whether partners are liable for whatever profits the firm may make whenever one of their members is a director, and only because he is a *director*. I agree that Section 16(b) does not go so far; but I wish to say nothing as to whether, if a firm deputed a partner to represent its interests as a director on the Board, the other partners would not be liable. True, they would not even then be formally 'directors'; but I am not prepared to say that they could not be so considered; for some purposes the common law does treat a firm as a jural person \* \* \*." (Italics supplied.)

Under the particular facts in the *Rattner* case, *supra*, the Court refused to hold the partnership liable for the short-swing profits which it realized, but affirmed a judgment against the partner-director for his proportionate partnership share of such profits. One of the grounds for this decision was the fact that *there was no evidence in the record* that Lehman Brothers had deputed its partner-director to represent its interests upon the issuer's Board, and *there was no evidence in the record* that the partner-director had disclosed any corporate information to the partnership. The plaintiff in that case presented

*no proof* with respect to the aforesaid facts but relied *solely* upon the naked proposition that a partnership is liable for all profits realized from its short-swing transactions in an issuer's securities *only because* one of its partners is a director of such issuer.

In the instant case, however, the record is abundantly clear that Lehman Brothers *actually deputed* its partner, Joseph A. Thomas, to represent its interests upon the Tide Water Board, and that Mr. Thomas *did disclose* to his firm certain information about Tide Water which he had acquired as a result of his fiduciary position, and that the short-swing transactions by Lehman Brothers were actually predicated upon such information.

Parenthetically, it may also be noted at this point that Mr. Thomas was fully aware at the time that Lehman Brothers was purchasing the common stock of Tide Water, that the firm's purpose was "to convert it and sell it because it is a high-grade stock and very desirable for institutional investors" (R. 49a).

Sound public policy in the enforcement of Section 16(b) requires that *all* profits realized by Lehman Brothers from its short-swing transactions in the Tide Water stock should be recovered from the *partnership*. Any other interpretation of the statute would be contrary to the Congressional purpose and would open the doors wide to indiscriminate stock manipulations by such corporate insiders.

## III.

**The partner-director, Joseph A. Thomas, is liable for all the profits which respondent, Lehman Brothers, realized as a result of its short-swing transactions in the Tide Water stock.**

The Court below *limited* the liability of the partner-director, Joseph A. Thomas by holding him accountable to Tide Water for only his *proportionate partnership share* of the short-swing profits realized by respondent, Lehman Brothers.

To construe Section 16(b) of the Act in such a manner that it will not reach under *any* circumstances more than a partner-director's proportionate share of his firm's short-swing profits is both unrealistic and perverse of the true legislative intent and purpose of the statute.

While it is true that in *Rattner v. Lehman* (C. A. 2), 193 F. 2d 564—followed by the Court below in this case—the partner-director was similarly held liable to the issuer for only his proportionate partnership share of the firm's short-swing profits, the *rationale* of the Court's opinion in that case was predicated *solely* upon the peculiar facts there involved. The Court stated that its reason for thus limiting the partner-director's liability stemmed from the fact that "the purchases and sales of Vultee Aircraft stock were made *without the knowledge* of Mr. Hertz (the partner-director)."

It would thus appear from the opinion in the *Rattner* case, *supra*, that where the partner-director has had "*knowledge*" of his firm's short-swing transactions, he would have been held liable for the *entire amount* of the partnership profits.

An analogous situation occurred in *Jefferson Lake Sulphur Co. v. Walet* (C. A. 5), 202 F. 2d 433, cert. denied, 346 U. S. 820, which was decided *subsequent* to the *Rattner* case, *supra*. In that case, the defendant, Walet, an officer of a listed corporation, was married and resided in the State of Louisiana, where the wife has a vested one-half interest in all marital property. The defendant had purchased and sold his issuer's stock within a six-month period, realizing profits therefrom. When the issuer instituted suit to recover the *entire* amount of such profits, the defendant sought to have his liability limited to only his proportionate community share of such profits, i. e., one-half.

In overruling the defendant's contention and holding him liable for *all* the short-swing profits, the Trial Court said (104 F. Supp. 20, 24):

"Under Section 16(b) of the Securities Exchange Act any profit realized by the defendant in his short term transactions must inure to the corporation. The only way to execute the congressional mandate in this case is for the corporation to receive all of the profit from these transactions, because any profit, however small, not recovered by the corporation, remains in the community in which the defendant has an indivisible one-half interest and over which, incidentally, he has complete control. Defendant's contention that the wife owned one-half of the stock when purchased and therefore one-half of the profit from the sales disregards the nature of the marital community and the ownership of its property. Neither the husband nor the wife owns the community property or any specific piece thereof. Each owns in division one-half of all of the property and this ownership must continue until the dissolution of the community by death or divorce. Consequently the wife owns no stock as distinguished from her husband nor any profits from stock transactions. Such profits as accrue must necessarily fall into the marital community of which the defendant is one-half owner."

The analogy between the *Jefferson Lake* case and the instant one is striking. In each case, the defendant owned an indivisible interest in all of the partnership or community property. In each case the defendant had "knowledge" of the purchases and sales.

In the instant case, the short-swing transactions of the Tide Water Preferred stock were effected by Lehman Brothers between December 8, 1954, and March 8, 1955 (Defts.' Ex. E; R. 126a, 168a). Respondent, Thomas, testified that he was informed of the proposed purchases and sales by his firm of Tide Water's Preferred stock at the time Lehman Brothers first commenced purchasing Tide Water common stock, i. e., about October 8, 1954, two months before the short-swing transactions actually occurred (R. 48a, 49a).

It is thus evident that the element of "knowledge," which the Court found lacking in the *Rattner* case, is present in the instant case and requires holding the partner-director, Thomas, liable for the entire short-swing profits realized by his firm.

In the *Rattner* case, the Court further said (pp. 565-566) that its conclusion to hold the partner-director liable "for only his proportionate share of the firm's profits finds further support in Rule X-16A-3(b) of the Securities and Exchange Commission which permits a partner to file a report 'only as to that amount of such equity security which represents his proportionate interest in the partnership.'"

Following the decision in the *Rattner* case, and concededly as a direct result thereof, the Securities and Exchange Commission, under Release No. 4718, dated June 18, 1952, "proposed that Rule X-16A-3 be amended to require any person who is a member of a partnership which owns securities of an insurer of which he is an officer, director or ten per cent stockholder to report the entire amount of such securities."



Rule X-16A-3(b) which was adopted by the Commission shortly thereafter provides that "A partner who is required under Section 240.16a-1 to report in respect of any equity security owned by the partnership shall include in his report the *entire amount* of such equity security owned by the partnership."<sup>15</sup>

In view of the aforesaid amendment of the SEC rule the stated rationale of the Court's opinion in the *Rattner* case is no longer applicable and must be re-evaluated. Since the SEC rule was deemed a valid reason advanced by the Court to *limit* the liability of the partner-director—the amendment of such SEC rule would seem to require the *broadening* of such liability to require the recovery of the "*entire*" partnership profits from such partner-director.

It is basic partnership law that each partner has an indivisible interest in the partnership property and funds. To limit recovery under Section 16(b) to the partner-director's proportionate partnership interest is to ignore the basic public policy of the statute.

In line with the express purpose of the statute, the Courts have extended the literal wording of Section 16(b) to encompass a multitude of other situations which might possibly lead to the evils which Congress sought to eradicate.

It is only by holding the partner-director liable for the *entire* short-swing profits realized by his firm that an effective prophylactic to the stated statutory policy can be fully enforced. The limitation of a partner-director's liability would open the door to wholesale evasion of the Act. Misuse of inside information by director-partner would redound to the advantage of the partnership firm, the members of which would undoubtedly be happy to re-

<sup>15</sup> 17 C. F. R. 240, 16a-3(b); Append. p. 53.

imburse the partner-director for his "proportionate" loss of partnership profits in return for his invaluable "inside tips."

In the *Rattner* case, *supra* (p. 565), the Court refused to conjecture "Whether the result might be different had he (the partner-director) caused the firm to make them (the short-swing purchases and sales)."

The evidence in the record abundantly demonstrates that the inside information concerning Tide Water's affairs which Mr. Thomas imparted to his partners was the cornerstone of his firm's ultimate decision to effect the short-swing transactions in that company's stock.

Such disclosures prompted Lehman Brothers to consummate the Tide Water stock transactions. Accordingly, it can truly be said that Mr. Thomas "caused" these transactions to be entered into by his firm as though he had personally given the orders therefor.

#### IV.

**The recovery should include interest from the date the respondents realized such short-swing profits.**

In awarding the limited judgment against respondent, Thomas, the Court below refused to allow any interest whatsoever upon the recovery although it recognized that the purpose of Section 16(b) is "to squeeze all possible profits" and "every possible penny of profit out of such transactions."<sup>16</sup>

In thus failing to grant any interest upon the short-swing profits recovered, the Court in effect *reduced* such

<sup>16</sup> *Smolowe v. Delendo Corp.*, *supra*, p. 239; *Blau v. Lehman*, *supra*, p. 791.

recovery by an amount equal to the interest earned by the respondents' use of the money from the date the profits were recoverable.

Although the statute is silent with respect to interest, the Courts have on all prior occasions awarded such interest as an incident of the recovery so as to carry out fully the legislative purpose inherent in the statute.<sup>17</sup>

Judge Clark in his dissenting opinion, expressly noted that "The final anomaly in our exceptional treatment of this case is the denial of all interest for the use of the sums found due to the corporations, contrary to our uniform practice in other cases."<sup>18</sup>

The complete fulfillment of the legislative purpose, which seeks to deter any "insider" from engaging in transactions prohibited by the statute, can only be effected by the removal of all economic benefits which may accrue therefrom. Unless such "insider" is charged with interest for the use of the monies to which he is not entitled, his statutory transgressions will be placed at a premium.

<sup>17</sup> *Park & Tilford, Inc., v. Schulte* (C. A. 2), 160 F. 2d 984; *Blau v. Mission Corp.* (C. A. 2), 212 F. 2d 77; *Magida v. Continental Can Co.* (C. A. 2), 231 F. 2d 843; *Stella v. Graham Paige Motors Corp.* (C. A. 2), 232 F. 2d 299, 302, Note 4; *Adler v. Klawans* (C. A. 2), 267 F. 2d 840; *Consolidated Engineering Corp. v. Nesbit* (DCSD Calif.), 102 F. Supp. 112.

<sup>18</sup> *Blau v. Lehman*, *supra*, p. 797.

**CONCLUSION.**

**The judgment dismissing the complaint as against respondents, Lehman Brothers, should be reversed; so much of the judgment which *limited* the recovery as against respondent, Joseph A. Thomas, should be reversed. Judgment should be entered against both respondents, Lehman Brothers and Joseph A. Thomas, jointly and severally, in the sum of \$98,686.77, together with interest, costs and disbursements.**

Respectfully submitted,

**MORRIS J. LEVY,  
Attorney for Petitioner.**

**APPENDIX.**

Sections 16(a) and 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Sections 78p(a) and 78p(b), provide as follows:

“(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

“(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security)

within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Section 3(a) (13) of the Securities Exchange Act of 1934, 15 USCA Section 78c (a) (13), defines "Buy" and "Purchase" as follows:

"The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."  
(Italics supplied.)

Securities and Exchange Rule X-16A-3(b), 17 CFR 240.16a-3(b), as amended, provides as follows:

"A partner who is required under Sect. 240.16a-1 to report in respect of any equity security owned by the partnership shall include in his report the entire amount of such equity security owned by the partnership. He may if he so elects, disclose the extent of his interest in the partnership and the partnership transactions."



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# In the Supreme Court of the United States

OCTOBER TERM, 1961

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No. 66

ISADORE BLAU, ETC., PETITIONER

v.

ROBERT LEHMAN, ET AL.

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ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE SECOND CIRCUIT

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BRIEF FOR THE SECURITIES AND EXCHANGE  
COMMISSION AS AMICUS CURIAE

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## OPINIONS BELOW

The opinions of the court of appeals (R. 174-192 and 198-203) are reported at 286 F. 2d 786. The opinion of the district court (R. 149a-157a) is reported at 173 F. Supp. 590.

## JURISDICTION

The judgment of the court of appeals was entered on December 20, 1960 (R. 193). A petition for rehearing was denied by the court *en banc* on February 21, 1961<sup>1</sup> (R. 198-199). The petition for a writ of

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<sup>1</sup> A request for *amicus curiae* participation by the Commission was also denied at that time (R. 198-199).

certiorari was filed on March 14, 1961 and granted on April 24, 1961 (R. 205). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

#### **QUESTION PRESENTED**

When a director of a corporation which has stock registered on a national securities exchange is also a partner in an investment banking firm which trades in the corporation's securities, may the corporation recover, under Section 16(b) of the Securities Exchange Act of 1934, the entire "short-swing" profits realized by the partnership or is recovery limited to the director-partner's proportionate ownership share of his firm's profits?

#### **STATUTE INVOLVED**

The portion of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), which is most directly involved provides:

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. \* \* \*

Sections 16(a) and 16(b) of the Securities Exchange Act of 1934 are set forth in full in an Appendix, *infra*, pp. 26-27.

**STATEMENT**

The stock of Tide Water Associated Oil Company ("Tide Water") is registered on the New York Stock Exchange. Petitioner, a stockholder of Tide Water, brought this action on behalf of the corporation under Section 16(b) of the Securities Exchange Act of 1934 to recover the profits realized by the firm of Lehman Brothers from purchases and sales of Tide Water stock within a period of less than 6 months. The complaint invoked the jurisdiction of the district court under Section 27 of the Securities Exchange Act of 1934.

Lehman Brothers is a partnership consisting of nineteen partners<sup>2</sup> and is a member of the New York Stock Exchange and other stock exchanges. The firm is engaged in the investment banking business, acts as a broker in securities, and trades in securities for its own account (R. 32a-33a). John A. Thomas, a partner of Lehman Brothers, was elected to the Tide Water board of directors on August 5, 1954, when his partner, John Hertz, resigned from the board. Mr. Thomas has served as a Tide Water director continuously since that date (R. 9a).

During the period October 8, 1954, to November 15, 1954, Lehman Brothers purchased for its own account 50,000 shares of Tide Water common stock (R. 43a-44a). On December 8, 1954, it converted these shares into a like amount of Tide Water preferred stock (R. 86a). The district court held that these acquisitions of the preferred stock constituted a "purchase" within

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<sup>2</sup> This is the number of partners named in the complaint (R. 4a-5a). Defendants' Exhibit D indicates there were 18 partners of Lehman Brothers at the end of 1955 when profits from the transactions involved were distributed (R. 119a-120a, 166a). The Commission's public records show that the firm now has 24 partners (SEC File No. 8-246-1).

the meaning of Section 16(b) and found that Lehman Brothers sold the preferred stock at a profit of \$98,686.77 within 6 months of these acquisitions (R. 156a).

Various partners in Lehman Brothers hold directorships in industrial and banking corporations (R. 33a).<sup>3</sup> While one partner testified that this practice has "[n]ot always" resulted from suggestions of the firm (R. 79a), John Hertz, the Lehman Brothers' partner who had been for many years Mr. Thomas' predecessor on the Tide Water board, testified in answer to the question whether it was (R. 65a) "the practice of Lehman Brothers to have some of its partners go on boards of corporations in order to further the interests of Lehman Brothers":

Well, I surely joined Tide Water Company thinking it was going to be in the interests of Lehman Brothers.

At the last board meeting prior to his resignation, Mr. Hertz suggested that his partner, Mr. Thomas, be named to succeed him, partly because it would be in the interests of Lehman Brothers (R. 64a-65a). Mr. Hertz felt he did not have to tell his partner that serving on the board of Tide Water would further the interests of Lehman Brothers since Mr. Thomas "is a smart fellow." (R. 64a). After Mr. Thomas became a director of Tide Water, Lehman Brothers participated with two other firms in underwriting \$50,000,000 of Tide Water bonds (R. 42a, 51a). Mr. Thomas was the partner assigned to the "Tide Water financing business" (R. 77a).

The purchases of Tide Water stock here involved

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<sup>3</sup> The Commission's public records currently disclose that partners of Lehman Brothers hold over 100 directorships (SEC File No. 801-364), many of which are in companies registered on national securities exchanges.



were authorized by William J. Hammerslough, the partner of Lehman Brothers in charge of its Portfolio Committee (R. 70a, 135a-136a). This Committee, which supervises the holdings of the firm, operates very informally and all members of the firm are sometimes invited to attend meetings (R. 70a, 81a). Although Mr. Thomas did not participate in the Committee discussions with respect to this purchase of Tide Water stock, he did have conversations with his partners concerning Tide Water affairs, suggesting "from time to time that I thought Tide Water under the new management was an attractive investment" and expressing "the opinion freely that I thought the management was first-rate, that the company would do well under that management" (R. 54a-56a). "Thomas spoke very highly of the management and prospects of" Tide Water to Mr. Hammerslough, with whom he had most extensive conversations concerning Tide Water (R. 55a, 69a).

When Mr. Thomas learned that purchases of Tide Water were being made by his firm he instructed the controller "to exclude me from any risk of the purchase or any profit or loss from the subsequent sale and to take the necessary steps to carry out my instructions." (R. 122a.) He and his partners agreed that he was to have no part in the transaction. (R. 123a).

After a trial without a jury, the district court dismissed the complaint against Lehman Brothers and entered judgment against Mr. Thomas for his proportionate interest in the partnership profits from the transactions involved, which amounted to \$3,893.41 out of the total partnership profits of \$98,686.77. No interest was allowed by the court (R. 158a). The court of appeals affirmed by a divided court (R. 174-192).

**SUMMARY OF ARGUMENT**

By providing in Section 16(b) of the Securities Exchange Act of 1934 that profits by insiders in "short-swing" transactions in stock of their corporations should be recoverable by the corporations, Congress intended to eliminate the "vicious practices" that resulted from trading by officers, directors and large stockholders on the basis of inside information. The legislative history shows that this trading was often conducted through organized "pools," in which members of investment banking firms played a prominent part. These practices were not only unfair to members of the investing public, with whom the insiders traded, but also led to manipulation of corporate affairs in order to promote trading profits for the insiders.

To allow recovery against the partner-director of only his share of his firm's profits from trading in the stock of his corporation, as did the majority below, gives only token effect to the legislative purpose of Section 16(b). With respect to large investment bankers such as the respondents' firm, the result is merely to reduce by a small percentage (in this case less than 4 per cent) the firm's total profits from transactions encompassed by Section 16(b), for the relationship between partners is such that one who must pay over the profits from one transaction will normally be otherwise compensated, perhaps by profits from the firm's trading in the stock of another corporation of which another partner is a director.

Section 3(a)(9) of the Securities Exchange Act defines "person" to include a partnership, making it clear that, for the purposes of the Act, a partnership group is to be treated as an entity, rather than as several individuals. Thus, a partnership is held to be

the insider when liability rests on a ten percent stockholding. Similarly, to carry out the intention of Section 16(b), the partnership should be treated as the "director" for purposes of liability under the Act in the circumstances of this case since the partner-director was, as a matter of law, acting for his partners.

In any event, the individual partner-director should be held liable for the entire profits from the transactions for under partnership law he is a co-owner of all property purchased with firm funds and of all profits realized from the sale of firm assets. Intra-partnership agreements as to the distribution of profits should not be permitted to control liability imposed by Congress for the protection of the public.

In comparable situations, the interposition of co-ownership has not been permitted to alter the impact of remedial liability. In equity, restrictions on a trustee with respect to dealings in trust property apply with equal force to a firm of which he is a member; and where other persons associate with a trustee in a breach of his fiduciary duties, both the trustee and his associates are held liable for the entire profits realized by the group. The Civil Aeronautics Board has treated partners as representatives of each other in enforcing its restrictions on intercorporate relationships in the industry. Under Section 249 of the Bankruptcy Act, which involves a denial of compensation as a rule-of-thumb deterrent to trading in the debtor's securities, the courts have consistently denied compensation to an attorney or other person when his firm, partner, or wife has purchased or sold securities of the debtor.

# ARGUMENT

**A Corporation, Which Has Stock Registered On a National Securities Exchange, May Recover Under Section 16(b) of the Securities Exchange Act of 1934 the Entire "Short-Swing" Profits Realized From Trading in the Corporation's Stock By a Partnership Which Has a Partner on the Board of Directors of the Corporation.**

## I

**CONGRESS INTENDED THAT A CORPORATION SHOULD RECOVER ALL THE PROFITS MADE IN "SHORT-SWING" TRANSACTIONS OF MEMBERS**

In enacting Section 16(b) of the Securities Exchange Act of 1934, Congress, by eliminating the opportunity for profit in "short-swing" transactions, intended to discourage the use of confidential corporate information for private profit, and the manipulation of corporate affairs to promote trading profits by insiders. The legislative history makes it clear that this intent encompassed partnership transactions as well as individual dealings. The nature of a partner's interest in his firm's transactions and profits prevents the remedy from being effective unless all partnership profits are required to be surrendered.

Section 16(b) of the Securities Exchange Act of 1934 ("the Act"), *supra*, p. 2, provides that "For the purpose of preventing the unfair use of information which may have been obtained \* \* \* by reason of his relationship to the issuer," a director, officer, or large stockholder is accountable to his corporation for any profits realized from the purchase and sale or the sale and purchase, within a 6-month period, of his corporation's stock registered on a national securities exchange.

The Congressional study on which the Act was based had demonstrated the urgent need for restraints against the use of inside information in "short-swing" trading by corporate fiduciaries in the securities of their cor-

porations. As stated in a Senate report (S. Rep. No. 1455, 73d Cong., 2d Sess., 1934, at p. 55):

Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others.

The report (S. Rep. No. 1455, *supra* at pp. 56-58) gave numerous illustrations of how these abuses had been accomplished through personal holding companies or pools in which a prominent part was played by large investment banking firms and their individual members, who were either directors themselves or collaborated with corporate fiduciaries. Not only was this activity unfair to the investing public, because the insiders had information not available to those with whom they traded, but the unrestricted trading of insiders led to deliberate manipulation of the affairs of their corporations for the purpose of enhancing their personal profits without regard to the effect on the corporation. Thus, it was found (S. Rep. No. 792, 73d Cong., 2d Sess. (1934) at p. 9):

In a particularly glaring instance, the chairman of the executive committee and another director participated in a pool organized to trade in the stock of their company when the stock was paying no dividends. During the operation of the

pool, which continued for a period of 2 years, they caused the company to resume the payment of dividends, more than 25 percent of which were received by the pool participants. These dividends were paid during the pool's operation in spite of the fact that the company's earnings were not sufficient to meet them and part of its surplus had to be diverted for that purpose. In another case, the president of the corporation testified that he and his brothers controlled the company with a little over 10 percent of the shares; that shortly before the company passed a dividend, they disposed of their holdings for upward of \$16,000,000 and later repurchased them for about \$7,000,000, showing a profit of approximately \$9,000,000 on the transaction.

Section 16 of the Act was the means adopted by the Congress to put an end to such practices. Under Section 16(a), Appendix, *infra*, p. 26, the officers, directors and ten-percent stockholders of corporations with equity securities registered on a national securities exchange are required to file with the Securities and Exchange Commission reports showing their ownership of such securities and, on a monthly basis, all changes in ownership. Under Section 16(b) profits realized by these insiders from trading in such securities within a 6-month period are recoverable by the corporation without proof of the actual use of inside information and, in fact, even if it is proved that the person had no inside information whatever.

The court below stated in *Smolowe v. Delendo Corporation*, 136 F. 2d 231, 239, certiorari denied, 320 U.S. 751:

We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible



profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty.

The decision below virtually defeats this intention. If recovery were limited to the portion of the profit applicable to the partner-director, as the court below held, an investment banking firm with 20 equal partners, no two of whom were officers or directors of the same corporation, could use inside information in short-swing trading *ad infinitum* and never have to disgorge more than five per cent of its profits. As to Lehman Brothers for example, the only effect of Section 16(b) would be to shave a small percentage of its profits on short-swing transactions. The larger the firm, the smaller, on the average, the reduction of profits will be. But the very size of a firm increases its opportunities for directorships and for greater exploitation of inside information.

Even from the point of view of the individual director, the requirement that he disgorge only his share of the profits is not effective. Its weakness does not depend upon the partnership directly reimbursing him for his loss, although it would be difficult to prevent it from doing so. Without direct reimbursement, a partner will naturally profit from his firm's insider transactions since he will share in the profits of the trading in securities of corporations in which his partners are directors. Thus, while he has to surrender the profits from trading in securities of his corporation, he will be compensated by receiving his proportionate share of the profits in other transactions when one or another of his partners may have to make the sacrifice for the com-



mon good. These consequences led Judge Clark to observe, in effect, that Section 16(b) should be repealed if the decision of the majority below is allowed to stand. He stated (R. 202-203) that the most serious vice of this holding

\*\*\* is the unfair discrimination it builds into an important remedial statute—a discrimination substantially eliminating the great Wall Street trading firms from the statute's operation. So great is the unfairness of the result that, notwithstanding its remedial nature, the statute, it would appear, should not stand unless its judicially discovered defects can be corrected. \*\*\*

The prevalence of partners of investment banking firms on the boards of directors of the country's large corporations is not mere coincidence.<sup>4</sup> Rather, it is the result of the deliberate effort of investment banking firms to establish close relationships with the issuers of securities. As was noted in *United States v. Morgan*, 118 F. Supp. 621, 652 (S.D. N.Y.), "the competition for business by investment bankers must start with an effort to establish or continue a relationship with the issuer," and the facts indicate that Lehman Brothers placed a partner on the board of Tide Water for this purpose (see pp. 3-4, *supra*).<sup>5</sup> Membership on boards of directors is intimately related to the business of investment banking, for it is a most effective means of establishing a close relationship. Thus, to disregard

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<sup>4</sup> These firms, like much of the securities industry, are customarily organized as partnerships. See H. Rep. No. 1278, 85th Cong., 1st Sess. (1957) at pp. XV, 74-81).

<sup>5</sup> The trial judge concluded that (R. 153a) "there was no evidence that the firm of Lehman Brothers deputed Thomas to represent its interests as a director on the board of Tide Water." Ordi-

the relationship of the Lehman directorships to the business of the firm is to discount a significant portion of the firm's goodwill. While the primary purpose of an investment banking firm in placing its partners on the boards of corporations may be to obtain underwriting business, it cannot be assumed in the light of the text and legislative history of Section 16(b) that a firm, which is also engaged in the business of trading in securities, will ignore in its trading activities the inside information obtained from partner-directors.

As we have seen, Congress in enacting Section 16(b) was aware of the prominence of the investment banking firms and their members in the pools organized for the specific purpose of profiteering with the use of inside information. It was this result which led Judge Clark to state (R. 186-187, 189):

I think the principle is anomalous in granting exemption in the very cases where the incentive to take insiders' profits is strongest as a part of a trading firm's normal business and where exception is the most difficult to understand.

\* \* \* the exemption of these firms would be hard to explain to the ordinary small-scale director not

narily, findings of fact will, if supported by the evidence, be accepted by a reviewing court. However, where the finding is in truth a conclusion, the reviewing court is free to draw its own conclusions from the basic facts which frequently are actually not in dispute. Cf. *United States v. DuPont*, 353 U.S. 586, 598.

The court in *Morgan* further noted (118 F. Supp. at 716):

Lehman Brothers, together with Goldman Sachs, was a leader in the pre-Securities Act period in developing directorship relations with its customers. And, with the development of the Industrial Department of Lehman Brothers, these directorships became an important feature of Lehman Brothers' method of servicing its customers.

so exempt and indeed to the investing public generally.

Even more anomalous is the color of legality that the holding below lends to the very abuses which Congress sought to eliminate. Partnership law requires each partner to render to the other partners full information on all matters affecting the partnership business.\* In the case of investment banking firms, the partnership business usually includes trading in securities. If short-swing trading by a partnership in securities of a corporation of which a partner is a director were to be sanctioned by this Court, the disclosure of inside information which offers profit-making possibilities to the partnership would be transformed from a vice which Congress condemned to a duty of the partner-director. This result would be completely at variance with the legislative intent of the broadly remedial provisions of Section 16(b), a result this Court should avoid even "sacrificing, if necessary, the literal meaning in order that the purpose may not fail." *Ozawa v. United States*, 260 U.S. 178, 194. See also *United States v. Public Utilities Commission of California*, 345 U.S. 295, 315; *United States v. American Trucking Associations, Inc.*, 310 U.S. 534, 543.

The court below adopted the district court's finding that the partnership trading was not based on inside information (R. 177) and concluded that accordingly it need not determine "whether the result might be different had Thomas caused the firm to enter the Tide Water venture" (R. 181). This is an approach which Judge Clark accurately characterized as forcing "the

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\* See N. Y. Partnership Law, Section 42, which is identical with Section 20 of the Uniform Partnership Act.

very step which we felt Congress had avoided, namely, a 'subjective standard of proof, requiring a showing of an actual unfair use of inside information' " (R. 188). It was precisely because of the difficulties of proof of reliance upon inside information that Congress determined to enact Section 16(b) as a "rule of thumb." Similar difficulties of proof exist as to whether a partner has advised other members of his firm of inside information. It is unlikely that the same Congress which took a prophylactic approach in framing Section 16(b) so as to avoid the practical problem of proving whether information was in fact used by an insider intended that the equally difficult problem of proving what goes on between partners in an investment banking firm was not to be solved by the same statute.

## II

### **SECTION 16(b) OF THE SECURITIES EXCHANGE ACT OF 1934 MAY PROPERLY BE INTERPRETED TO COMPEL SURRENDER OF ALL THE PARTNERSHIP PROFITS**

The courts below decided against liability for the full amount of the profits because they believed that the language of Section 16(b) prevented that result. In their view the partnership itself was not liable to

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<sup>7</sup> See Hearings Before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., pursuant to S. Res. 84, 72d Cong. and S. Res. 56 and S. Res. 97, 73d Cong., 2d Sess. (1934) at p. 6557. Early drafts of the bill which ultimately became the Securities Exchange Act contained a provision for recovery of "short-swing" profits realized by anyone proved to be acting on the basis of inside information. This provision was dropped from final drafts because of anticipated difficulties of enforcement. See Hearings Before the Senate Committee on Banking and Currency, *supra*, at pp. 6560-6561; Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess. (1934), pp. 135, *et seq.*; *Smolow v. Delendo Corporation*, 139 F. 2d 231, 236 (C.A. 2).

account because it was not a "director"; and the director, Mr. Thomas, was not required to account because he did not "realize" the partnership profits. Neither of these objections is valid.

1. Section 3(a)(9) of the Securities Exchange Act defines the term "person" to include a "partnership." The intent of this definition is, of course, to treat a partnership as an entity subject to regulation, rather than as merely a number of persons acting in concert. Thus, when restrictions are imposed on, or liability exacted from, "persons," the law applies equally to partnerships as such, rather than solely to their individual members. The recovery of insider profits directed against stockholders holding a ten percent interest in a corporation is equally applicable to partnership holdings. The partnership and its members are inseparable; therefore the partnership is considered the insider.

A like construction should be given the Act with respect to the application of Section 16(b) to profits by directors. The essence of Section 16(b) liability described above requires that the partnership itself be treated as the real insider. It is the partnership's expertise which is ordinarily made available to the corporation, and it is the partnership which profits from the business relationship established. While it is quite true that under corporate law only natural persons may be directors, for the purpose of Section 16(b) we are not concerned with corporate law, but with the practical problem of protecting the public interest against short-swing trading by insiders. Therefore, when a member of a partnership holds a directorship with the knowledge and consent of his firm, it is entirely

reasonable to consider the partnership as the "director" for the purposes of Section 16(b).

Since Mr. Thomas accepted the directorship in Tide Water with the knowledge of his partners; since such an action by a partner of Lehman Brothers was not an occasional or isolated event, but entirely consistent with the business practices of the firm; and since advising and representing such industrial concerns as Tide Water in their financial affairs was an important part of Lehman Brothers' business, Mr. Thomas must, as a matter of law, be considered to have been acting within his authority. As we have noted, the lower courts' determinations to the contrary are essentially legal conclusions. See footnote 5, *supra*, p. 12. In these circumstances Mr. Thomas and the partnership are inseparable for the purposes of Section 16(b) as a matter of law. We do not have to consider what the situation would have been had Mr. Thomas been acting in a field unrelated to the partnership business and without its knowledge.

Judge Learned Hand, concurring in *Rattner v. Lehman*, 193 F. 2d 564 (C.A. 2), which involved a holding similar to that below, was troubled by the possibility of the situation where a partner is deputized by his partnership to serve on a corporate board of directors. He stated (p. 567):



\* \* \* but I wish to say nothing as to whether, if a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable. True, they would not even then be formally "directors"; but I am not prepared to say that they could not be so considered; for some purposes the common law does treat a firm as a jural person.\*

We believe it is unnecessary that there be a formal deputization for this result to obtain.

In view of the fact that the sanction of Section 16(b) is admittedly designed as a rule of thumb to make unnecessary the proof of the existence of inside information in particular cases, it is entirely reasonable to apply the same rule of thumb to a partnership situation without specific proof that the partner was installed as a director to aid his partnership or that he transmitted inside information to his associates.

2. Regardless of the liability of the firm as such, we urge that in any event Mr. Thomas should be held

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\* At the time of the *Rattner* case the Commission's Rule X-16a-3 implementing the reporting requirements of Section 16(a) allowed a partner-director to report only that amount of the equity securities of his corporation held by his partnership which represented his proportionate interest in the partnership. The *Rattner* litigation served to focus the attention of the Commission on the easy evasion of Section 16(b) available where full partnership profits from trading are not reported, and changes in this rule were being considered even before the litigation was completed. The rule, 16a-3, 17 CFR 240.16a-3 (1961 Supp.), was subsequently amended to require that a partner-director report the entire amount of the equity securities of his corporation held by his partnership. See Securities Exchange Act Release No. 4754 (1952). These requirements have now been incorporated into the instructions for the use of Form 3 adopted by the Commission for reports required to be filed pursuant to Section 16(a).



liable for the entire profits from the transactions. All partners are co-owners of all property which is purchased with firm funds. Purchases and sales of securities by the partnership are in legal effect purchases and sales by all of its partners.\* While the profits of the enterprise may be divided among the partners in any proportions upon which they agree, this agreement cannot be permitted to control the issue of the extent of a partner's liability. Just as the courts below refused to permit a waiver of profits from the particular transactions to control liability, so, on a parity of reasoning, the arrangement that 96 per cent of the profits should go to others should similarly not be controlling.

As Judge Clark observed (R. 187-188):

I submit that on a literal *legal* reading of the statute, Thomas was co-owner with all the other partners of the Tide Water stock when bought and of the profits when sold, and that Thomas stood at all times legally charged with full knowledge of what was going on in his firm, just as the other partners had like knowledge. Further, I do not doubt that in any ordinary well-run partnership, the practical facts of life actually coincide with these legal facts, and that one partner either actually knows what is going on in his group or is content to leave action to his colleagues. In any event, the legal situation seems clear—so much so that in my view co-owners cannot be excluded from

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\* New York Partnership Law, Section 51, which is identical with Section 25 of the Uniform Partnership Act.

the operation of the statute without a serious distortion of its terms.

The result reached in *Walet v. Jefferson Lake Sulphur Co.*, 202 F. 2d 433 (C.A. 5), certiorari denied, 346 U.S. 820, points in the same direction as the reasoning employed by Judge Clark, although it dealt with husband and wife ownership in a community property state, rather than with ownership by a partnership. In *Walet*, even though only the husband was a director of the issuing corporation and the wife owned a half interest in the stock under community property law, the entire short-swing profits of both husband and wife were recovered under Section 16(b). The wife was no more a director of the issuing company in that case than were Mr. Thomas' partners directors in *Tide Water*."

### III

#### IN COMPARABLE SITUATIONS THE INTERPOSITION OF CO-OWNERSHIP HAS NOT BEEN PERMITTED TO ALTER THE IMPACT OF REMEDIAL LIABILITY

The courts have repeatedly shown "[u]ncompromising rigidity" in dealing with evasion of fiduciary duties; their aim is to insure that "the level of conduct for fiduciaries [be] kept at a level higher than that trodden by the crowd," *Meinhard v. Salmon*, 249 N.Y. 458, 464. Thus, restrictions on a trustee's dealing with the trust apply with equal force to a firm of which he is a member. *Magruder v. Drury*, 235 U.S. 106, 118-120;

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<sup>10</sup> To the extent that the opinion in *Walet* is predicated upon the right of a husband to control a wife's half interest in community property its precedent value here is weakened but that right is somewhat analogous to the right of each partner to bind all other partners in any action he undertakes in the name of the partnership.

*Higgins v. Shenango Pottery Company*, 279 F.2d 46 (C.A. 3) certiorari denied *sub nom. Zahniser v. Higgins*, 364 U.S. 899; *In re Hallenback's Estate*, 122 F. Supp. 212 (D. D.C.); *Burr v. Contenti*, 102 N.J. Eq. 41, 43; *Hornor v. New South Oil Mill*, 130 Ark. 551, 558. And in *Jackson v. Smith*, 254 U.S. 586, where nonfiduciaries knowingly associated with a trustee in purchasing property of the trust, this Court held the trustee and his associates jointly and severally liable for all the profits realized by the joint venture. See also *Irving Trust Company v. Deutsch*, 73 F. 2d 121 (C.A. 2), certiorari denied, 294 U.S. 708.

In *Lehman v. Civil Aeronautics Board*, 209 F. 2d 289 (C.A. D.C.), certiorari denied, 347 U.S. 916, the court sustained the determination of the Civil Aeronautics Board that partners of Lehman Brothers who served as directors of air carriers, other common carriers, or other companies engaged in the aeronautics business were representatives of each other, an interlocking relationship generally prohibited by Section 409(a) of the Civil Aeronautics Act of 1938. The court there noted that the partners feel "free to solicit" security underwriting and merger negotiation services for Lehman Brothers "who have been employed for these purposes not infrequently by Section 409(a) companies" (209 F. 2d at 293). Accordingly, it concluded: "This is representation within not only the language but the meaning of the statute" (209 F. 2d at 294).

In *Mosser v. Darrow*, 341 U.S. 267, two key employees of a trustee of an estate in reorganization under the Bankruptcy Act profited from trading in the securities of the debtor. This Court held the trustee, who permitted the trading, liable for their profits, stating that equity would have deprived him of the

profits had he traded, and that "delicate inquiries" as to his relationship with his employees should be avoided. It stated (341 U.S. at 271-272):

These strict prohibitions would serve little purpose if the trustee were free to authorize others to do what he is forbidden. While there is no charge of it here, it is obvious that this would open up opportunities for devious dealings in the name of others that the trustee could not conduct in his own. The motives of man are too complex for equity to separate in the case of its trustees the motive of acquiring efficient help from motives of favoring help, for any reason at all or from anticipation of counter-favors later to come. We think that which the trustee had no right to do he had no right to authorize, and that the transactions were as forbidden for benefit of others as they would have been on behalf of the trustee himself.

Evasions of the "rule of thumb" embodied in Section 249 of Chapter X of the Bankruptcy Act, 11 U.S.C. 649, which is comparable to the "rule of thumb" here involved," have not been tolerated. Section 249 provides that "[n]o compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who \* \* \* has purchased or sold \* \* \*

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<sup>11</sup> See statement of Commissioner (now Justice) Douglas in Hearing before the House Committee on the Judiciary on H.R. 8046, 75th Cong., 1st Sess. (1937), p. 184:

We visualized a lot of administrative difficulties in determining in a particular case whether or not actual inside information was used, and so we decided that the best practical way of doing it was to broaden the base a little bit and establish a rule of thumb and follow the pattern of the *Paramount* case and the *Republic Gas* case.

<sup>12</sup> See footnote 7 on page 15.

stock" of the debtor. As in the case of Section 16(b), Congress enacted Section 249 to guard against the possible conflicts of interest arising from trading on the basis of inside information and determined that its provisions must apply regardless of whether in a particular case actual injury or use of inside information could be demonstrated. Although Section 249 by its literal terms restricts trading only by "person[s] acting \* \* \* in a representative or fiduciary capacity," the courts have consistently invoked its provisions to bar compensation to an attorney or other person when his firm, partner, or wife has traded in securities of the debtor. See *Surface Transit, Inc. v. Saxe, Bacon & O'Shea*, 266 F. 2d 862, 868 (C.A. 2); *In re Central States Electric Corp.*, 206 F. 2d 70, 71-72 (C.A. 4), certiorari denied *sub nom. Henis v. Egan*, 346 U.S. 899; *In re Reynolds Investing Company*, 130 F. 2d 60 (C.A. 3); *In re Los Angeles Lumber Products Company*, 37 F. Supp. 708 (S.D. Calif.); *In re Inland Gas Corporation*, 73 F. Supp. 785, 791-792 (E.D. Ky.); *In re Midland United Company*, 64 F. Supp. 399, 416-417 (D. Del.). See also *In re Mountain States Power Company*, 118 F. 2d 405, 407-408 (C.A. 3). Cf., *Securities and Exchange Commission v. Dumaine*, 218 F. 2d 308, 312-316 (C.A. 1), certiorari denied, 349 U.S. 929, involving the comparable provisions of Rule 62 under the Public Utility Holding Company Act of 1935. As stated in *In re Los Angeles Lumber Company*, where it had been contended that Section 249 did not bar compensation to the firm or innocent partners thereof because of trading by one partner in the bonds of the debtor (37 F. Supp. at 711):

The court feels that in a situation such as this, each member of a law firm should share the respon-

sibility for the individual acts of another partner or other partners. To construe Section 249 otherwise would largely destroy its effectiveness. The relationship between partners is too close to make it possible to insure that compensation allowed to an innocent partner may not ultimately benefit a guilty partner, directly or indirectly. If Section 249 were to be construed as suggested, it might be possible to work out evasions of its provisions whereby one partner traded and another did legal work.

Unlike Section 249 of Chapter X of the Bankruptcy Act, the sanction of Section 16(b) cannot have the harsh effect of depriving a fiduciary of compensation earned by years of otherwise devoted labor.<sup>13</sup> All that is sought here is recovery of profits from a short term employment of capital—profits which Congress has determined must inure to the corporation to maintain the integrity of the fiduciary relationship between the corporation and its officers, directors and controlling shareholders.

#### CONCLUSION

For the foregoing reasons the judgment of the ~~dis-~~<sup>district</sup> court <sup>by the court</sup> should be reversed and remanded for entry of judgment against the respondents for the entire

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<sup>13</sup> See e.g., *In re Third Avenue Transit Corporation*, 159 F. Supp. 440, 443-444 (S.D. N.Y.), *affirmed sub nom. Surface Transit, Inc. v. Saxe, Bacon & O'Shea*, 266 F. 2d 862 (C.A. 2).

profits realized by the partnership from the short-swing transactions in the stock of Tide Water.

Respectfully submitted,

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August 1961.



## APPENDIX

Section 16 of the Securities Exchange Act of 1934.  
48 Stat. 896, 15 U.S.C. 78p

## DIRECTORS, OFFICERS, AND PRINCIPAL STOCKHOLDERS

(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent

jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

\* \* \* \* \*

BLACK J.

Office Supreme Court, U.S.

FILED

SEP 18 1961

JAMES S. BROWNING Clerk

# Supreme Court of the United States

OCTOBER TERM, 1961

No. 66

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

*Petitioner,*

—against—

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of Lehman Brothers, JOSEPH A. THOMAS, and TIDE WATER ASSOCIATED OIL COMPANY,

*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

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# Supreme Court of the United States

OCTOBER TERM, 1961

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

*Petitioner,*

*—against—*

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of Lehman Brothers, JOSEPH A. THOMAS, and TIDE WATER ASSOCIATED OIL COMPANY.

*Respondents.*

No. 66

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT  
OF APPEALS FOR THE SECOND CIRCUIT

**BRIEF OF RESPONDENTS OTHER THAN TIDE  
WATER ASSOCIATED OIL COMPANY**

### **Opinions Below**

The opinions of the Court of Appeals (R. 174-192; 198-203) are reported at 286 F. 2d 786. The opinion of the District Court (R. 149a-157a) is reported at 173 F. Supp. 590.

### **Jurisdiction**

The judgment of the Court of Appeals was entered on December 20, 1960 (R. 193). A petition for rehearing was denied by the Court of Appeals on February 21, 1961 (R. 198-199). The petition for a writ of certiorari was filed on March 14, 1961 and granted on April 24, 1961. The jurisdiction of this Court was invoked under 28 U. S. C. § 1254 (1).

### **Statutes Involved**

The relevant sections of the Securities Exchange Act of 1934 provide:

Section 3(a) (Title 15 U. S. C. § 78c(a))

"When used in this chapter, unless the context otherwise requires—

\* \* \*

(7) The term 'director' means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated."

Section 16(a) (Title 15 U. S. C. § 78p (a))

"Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the

registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

Section 16(b) (Title 15 U. S. C. § 78p(b))

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized.

This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

**Section 23(b) (Title 15 U. S. C. § 78w(b))**

"The Commission and the Board of Governors of the Federal Reserve System, respectively, shall include in their annual reports to Congress such information, data, and recommendation for further legislation as they may deem advisable with regard to matters within their respective jurisdictions under this chapter."

**Questions Presented**

1. Was not the Court of Appeals correct in holding that a partnership, one of whose members is a director of an issuer, is not liable to account to the issuer for short swing profits realized by its non-director partners, and in holding that the partner who was a director is not liable to account for more than what would have been his pro rata share of such profits had he received it, especially where the Court of Appeals concurred in the findings of the District Court (a) that the partner-director was not acting on behalf of the partnership as a director, and (b) that the partnership's purchases and sales of securities of the issuer were not initiated by such director nor were they based on any confidential information imparted by him.

2. Was not the Court of Appeals correct in holding that the District Court did not abuse its discretion in refusing to award interest on that amount which would have been the partner-director's pro rata share had he received it?

**Statement**

The facts as they appear in the record and as found by the courts below are as follows:

In 1954 respondent John Hertz, then a partner of Lehman Brothers, resigned all but one of eight to ten directorships then held by him, including his directorship on the Board of Tide Water (R. 61a, 38a, 150a). Mr. Hertz testified that there was no discussion among his partners about "getting" another member of the firm in Hertz's place on the Tide Water board (R. 63a). After resigning from Tide Water, Mr. Hertz spoke with Mr. Staples, President of Tide Water, and recommended respondent Joseph A. Thomas, a partner of Lehman Brothers, as a prospective director of Tide Water (R. 64a, 150a). Mr. Hertz told Mr. Staples that he "had a very smart young partner who knew much more about the oil business than [he] did" (R. 64a). At that time Mr. Thomas was a member of the board of directors of a number of banking and industrial corporations (R. 33a). Mr. Hertz then asked Mr. Thomas whether he would like to become a director of Tide Water and Thomas said that he would (R. 64a, 150a). Hertz never heard any more about it (R. 64a). Mr. Thomas was subsequently introduced to Mr. Staples by John Schiff, a partner of the investment banking firm of Kuhn, Loeb & Company and a director of Tide Water (R. 36a, 37a, 137a, 150a, 179). Mr. Staples and Mr. Thomas lunched together several times and "after a month or two he rang me up one day and asked me if I would like to be a director . . ." (R. 36a, 150a). Mr. Thomas was elected to the Tide Water board on August 5, 1954 (R. 32a, 38a).

Mr. Thomas had no discussion with any of his partners with regard to Mr. Staples' invitation except that Thomas,

naturally pleased with Tide Water's offer, told respondent Robert Lehman, his senior partner, of the invitation (R. 41a). Mr. Lehman congratulated Mr. Thomas but did not urge him to accept the invitation (R. 41a). Respondent William Glazier testified that no members of the firm in his presence or to his knowledge suggested to Mr. Thomas that he attempt to be elected a director of Tide Water (R. 85a). Respondent Monroe C. Gutman testified that he never discussed with any member of the firm nor ever heard any discussion among any partners of Lehman Brothers that Mr. Thomas had been proposed for the Tide Water board of directors (R. 80a). Respondent William J. Hammerslough testified that he had no discussions with Mr. Thomas or anyone else relating to Thomas' election to the Tide Water board (R. 72a, 73a), and that he did not have any discussions with any of his partners or know of any discussions concerning the advisability of having one of his partners "take Mr. Hertz's place" on the Tide Water board (R. 73a). During Thomas' service as a Tide Water director none of his partners requested that he do anything to further the interest of Lehman Brothers (R. 53a), and he had no discussions with them concerning Tide Water's affairs or operations (R. 34a, 56a, 150a).

On the basis of these facts, the District Court found that the invitation to Thomas to join the Tide Water board was upon the initiative of Tide Water and that Thomas accepted the directorship because of his interest in the oil business and because of the prestige factor involved in serving on the board of a large corporation (R. 150a). The Court of Appeals concurred in the finding that Lehman Brothers took no action to cause Thomas to be made a director and that the invitation to Thomas came from Tide Water (R. 176, 179, 180). The District Court also found as a fact that Thomas had not been deputed to represent



the interests of Lehman Brothers on the Tide Water board (R. 153a). The Court of Appeals concurred in this finding of fact:

"... the evidence in this case will not support an inference that Lehman Brothers deputized Thomas to represent its interests as director on the board of Tide Water. Doubtless the firm was pleased to have Thomas succeed Hertz as a director, and so was John Schiff, of Kuhn, Loeb & Company, who introduced his friend Thomas to David T. Staples, president of Tide Water who thereafter invited Thomas to become a director. *However, there is no evidence of any deputizing or other affirmative action by the firm to cause Thomas to be made a director to protect the interests of the firm or to become its representative.*" (R. 179; emphasis supplied)

In an article published in the *Wall Street Journal* on September 17, 1954, Tide Water announced that it was considering a proposal to allow shareholders to exchange common stock for a new dividend-paying-preferred stock (Defendants' Exhibit "A"; 162a, 75a). On October 8, 1954 a second article appeared in the *Wall Street Journal*, which announced that the Tide Water Board of Directors had approved a plan of recapitalization creating an issue of \$1.20 dividend cumulative preferred stock, and providing that holders of Tide Water common stock could exchange their common stock on a share for share basis for such preferred stock (Defendants' Exhibit "B"; 163a, 75a, 176, 177).

On October 8, 1954, after publication of the second article, Messrs. Hammerslough and Glazier, members of the investment committee of Lehman Brothers, met with Mr. Herman Kahn, also a partner of Lehman Brothers, and determined to purchased 50,000 shares of Tide Water common stock because the "preferred stock into which the



common stock was going to be exchanged subject to the approval [of the Tide Water shareholders] would be a very, very safe, good investment, and would be attractive, once it was issued, to institutional investors throughout the country." (71a, 83a-85a, 177).

Between October 8, 1954 and November 15, 1954 Lehman Brothers purchased in the regular course of its business 50,000 shares of Tide Water common stock at an aggregate cost of \$1,330,800 (150a, 169a).

As soon as Thomas learned of the firm's first acquisition of Tide Water's common stock he completely disassociated himself from the transaction and from the firm's activities with respect thereto (R. 122a, 123a). He immediately instructed the firm's controller to exclude him (Thomas) "from any risk of the purchase or any profit or loss from the subsequent sale and to take the necessary steps to carry out my [Thomas'] instructions" (R. 122a). None of Thomas' capital in the firm was at risk (R. 122a, 123a) and he did not share in any of the profits realized from the transactions (R. 123a, 116-120a; Defendants' Exhibit "C", 165a, 142a; Defendants' Exhibit "D", 167a, 142a). In addition, at the next partners meeting, held on the following Monday, he told his partners that he wanted them all to know that he was not a part of Tide Water transaction and that he excluded himself from any profits or losses (R. 123a). They agreed (R. 123a).

On December 8, 1954, pursuant to the plan of recapitalization, Lehman Brothers exchanged its 50,000 shares of Tide Water common stock for 50,000 shares of a new preferred stock (R. 151a). Between December 9, 1954 and March 8, 1955 Lehman Brothers sold its 50,000 shares of preferred stock realizing in the aggregate the sum of \$1,361,186.77 (151a, Defendants' Exhibit "E", 169a, 126a). On an investment of approximately one and one-

third million dollars Lehman Brothers realized a profit of \$30,386.77.\*

Mr. Thomas testified that he had not talked with any of his partners with respect to Lehman Brothers' purchase of Tide Water common stock (R. 45a, 56a, 57a, 139a, 151a, 177). All the witnesses with knowledge of the subject testified that Thomas did not speak with them concerning the investment in Tide Water and, to their knowledge, did not speak with anyone in Lehman Brothers concerning it (R. 67a, 71a, 80a, 85a, 137a). In the face of this testimony, petitioner, himself, conceded that none of the respondents spoke to Mr. Thomas concerning the proposed change in Tide Water's capital structure (R. 146a).

The District Court found as a fact that Thomas was not consulted by his partners as to the issuance of the new Tide Water stock and that it was bought and sold by Lehman Brothers without any advice or concurrence of Thomas (R. 150a). The Court of Appeals concurred in this finding of fact (R. 177, 181).

Both the District Court and the Court of Appeals found as a fact that Lehman Brothers' purchases of Tide Water common stock were made solely on the basis of information found in the two articles published in the *Wall Street Journal* and not on the basis of confidential information (R. 150a, 176-77). While Thomas testified that he stated to his partners and to others that he thought well of the

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\*The profit of \$30,386.77 is the excess of the price received on the sale of the preferred stock over the cost of the common stock. The District Court, however, in determining the amount for which Thomas was accountable, found that the cost of the preferred stock was the lowest price at which the common stock sold on December 8, 1954, the date of exchange. Since that price was lower than the actual cost (to Lehman Brothers) of the common stock, the District Court's determination that the total profit was \$98,686.77 was based on a theoretical purchase of preferred stock on the day of the exchange of common stock for preferred stock and did not reflect the actual dollar results of the transactions.

management of Tide Water, the Court of Appeals noted that Thomas' statements were "a far cry from the giving of confidential information" concerning the Tide Water issuance of common stock and exchange offer (R. 181).

Both the District Court and the Court of Appeals concurred in findings of fact that Thomas had disassociated himself from the transaction and received no part of the profits (R. 152a, 177, 185). The District Court, held, however, that Thomas' waiver to his partners did not prevent him from "realizing" what would have been his proportionate share of the firm's profits. Relying upon *Helvering v. Horst*, 311 U. S. 112 (1940), a tax case adopting a similar approach, the District Court stated that "by making such transfer of profits he [Thomas] was disposing of profits and to that extent he 'realized' the profits" (R. 155a). The Court of Appeals agreed with this holding.

### Summary of Argument

Section 16(b) of the Securities Exchange Act of 1934 requires only three specified classes of persons to account to a corporate issuer for "short-swing" profits realized by them, namely (1) directors, (2) officers, and (3) holders of 10% of any class of any equity security of an issuer. The firm of Lehman Brothers is neither a director, officer or 10% stockholder, and under the plain words of Section 16(b) other classes of persons are not accountable.

The clear meaning of the words of Section 16(b) is buttressed by a legislative history which establishes that Congress did not intend that anyone, other than those specified in the Act, would be accountable to a corporate issuer for "short swing" profits realized by them. In its consideration of the bills which ultimately became the Act,

Congress was presented with questions similar to those now confronting this Court.

Drafts of Section 16(b) submitted to Congress would have made it unlawful for an insider to disclose confidential information and would have imposed an obligation to account for "short-swing" profits upon any person to whom unlawful disclosure was made. Congress advisedly deleted both of these provisions from Section 16(b) and it thus specifically considered and refused to provide a right of recovery to corporations for "short-swing" profits realized by third parties who received or had access to confidential information through insiders. The legislative intent is clearly demonstrated by the history and the words chosen by Congress; it cannot be ignored in favor of a different policy, no matter how "logical" it is claimed to be.

For this reason, the Second Circuit in *Rattner v. Lehman Brothers*, 193 F. 2d 564 (2d Cir. 1952) held, under circumstances identical to the case at bar, that neither the partners of a director nor the director himself are obligated to account for "short-swing" profits realized by the non-director partners. The court found that "the legislative history indicates that the omission of any provision for such liability [the accountability of a director's partners for profits realized by them] was intentional" (193 F. 2d at 566).

Neither the Securities and Exchange Commission, prior to this case, nor Congress, at any time, has ever raised any objections to the *Rattner* rule, laid down in 1952, or ever given any indication that it could not be relied upon. To the contrary, in connection with an amendment to a Commission rule which required a partner-director to report all changes in the beneficial ownership of equity securities held by his partnership, the Commission specifically stated that the amended rule was "not intended as a modification of the principles governing liability for shortswing

transactions under Section 16(b) as set forth in the case of *Rattner v. Lehman*. . . .” And the Commission has never chosen to exercise its power under Section 23(b) of the Act to recommend legislation to Congress which would eliminate the disastrous consequences now allegedly resulting from the *Rattner* rule. Thus, for a period of nearly thirty years, the Commission has not sought to impose liability upon a person who is not a member of the three groups specified in the statute, whether he be a relative, spouse, friend, partner, or other business associate of an insider.

It is not a proper judicial function to expand the scope of a provision carefully limited by Congress, particularly when that provision, based upon a series of legislative findings and resultant conclusive presumptions, imposes an absolute liability. Lehman Brothers could be held accountable under Section 16(b), therefore, only if it were a director, officer or 10% stockholder of Tide Water. There is no claim that Lehman Brothers was within either of these latter two categories. Furthermore, it was not a “director” as that term was defined by Congress. The term director, as used in Section 16(b) of the Act, is specifically defined in Section 3(a)(7) to mean a person performing the functions of a director for an issuer. Lehman Brothers never performed any director functions for Tide Water. Lehman Brothers did not appoint or have the power to appoint Thomas to the Tide Water Board nor did Thomas represent Lehman Brothers on the Tide Water Board. Both courts below have concurred in findings to this effect; since those findings are adequately supported they should not be disturbed.

Thus, the allegations of deputation and representation not only were unproved in the courts below but they are concepts without relevance to liability under the Act. Had Congress intended to include the concept of directorship by deputation in Section 16(b), or to treat partners of directors

as directors, it could have and would have said so. For example, Section 17 of the Public Utility Holding Company Act of 1935 provides that no registered holding company shall have as a director any partner of an investment banker. Similarly, Sections 30(f) and 2(a)(3)(D) of the Investment Company Act of 1940 impose the obligations of Section 16(b) of the Securities Exchange Act of 1934 upon partners of an investment adviser.

Respondent Thomas is not obligated to account for more than his own pro rata share of the profits realized by the firm. Section 16(b) imposes liability upon a director only for "any profit realized by him". The legislative history demonstrates that Congress was perfectly aware that Section 16(b) did not reach profits realized by non-insiders, and it deliberately refrained not only from making an insider answerable for such profits but from making it unlawful for an insider to disclose confidential information to third parties.

Thomas at no time was entitled to nor did he share in or exercise any control over the profits received by the other members of Lehman Brothers. Thomas was not a co-owner of Tide Water securities when purchased, but even if he were, such fact could not create liability in Thomas for profits realized by his partners since co-ownership of partnership property cannot be equated with co-realization of partnership profits. Partnership law is clear that Thomas did not have an indivisible interest in the profits of the firm and that his only interest in the profits resulting from the Tide Water transaction was his 4% share, as provided in the partnership agreement.

The judgment rendered against Thomas for what would have been his pro-rata share of the firm's profits had he received it was based on the premise that Thomas could not transfer to his partners his share of the profits without exercising such dominion over those profits that



he "realized" them within the meaning of Section 16(b). It is moreover, undisputed that as a result of this disassociation of himself from the transactions Thomas never received even his purported share of such profits. To award interest on the judgment against him would be penal and inequitable.

## ARGUMENT

### I

**THE FINDINGS OF FACT BY THE TWO COURTS BELOW ARE ADEQUATELY SUPPORTED AND SHOULD NOT BE DISTURBED.**

Petitioner continues to rely here on the two factual premises which he repeatedly asserted at trial formed the cornerstone of his case, namely, (1) that Thomas disclosed confidential information concerning Tide Water to his partners and (2) that Thomas was deputized by Lehman Brothers to protect its interests and to represent it on the Board of Directors of Tide Water. The District Court and the Court of Appeals found that Thomas did not disclose any confidential information to any of his partners and that Lehman Brothers' purchases of Tide Water common stock were made solely on the basis of public information found in two articles published in the *Wall Street Journal*. Moreover, both courts below found as a fact that the invitation to Thomas to become a member of the Tide Water board emanated from Tide Water and that Lehman Brothers neither took any action to cause Thomas to be made a director nor deputized Thomas to represent its interests on the Tide Water board.

Under familiar rules, none of these findings should now be disturbed or disregarded unless clear error is shown.



*United States v. Real Estate Boards*, 339 U. S. 485, 495-96 (1950); *Virginia Ry. v. System Federation*, 300 U. S. 515, 542 (1937); *United States v. Yellow Cab Co.*, 338 U. S. 338 (1949); *Texas & N. O. R. Co. v. Railway Clerks*, 281 U. S. 548, 558-560 (1930); Robertson & Kirkham, *Jurisdiction of the Supreme Court of the United States* (Wolfson & Kurland ed. 1951) pp. 657-61. Petitioner makes no attempt to demonstrate that the findings of the courts below are not based upon substantial evidence in the record; indeed, petitioner's brief avoids all findings of fact and by various citations to testimony out of context and by inaccurate quotation (Compare Pet. Brief, pp. 4-6 with R. 60a-67a) he urges this Court to draw inferences at variance with those drawn by the courts below. And the Commission, while recognizing that this Court will not review the facts as found by the lower courts, requests this Court to draw its own "conclusions" from the basic facts, particularly with respect to whether Thomas was deputed by Lehman Brothers to represent its interest on the Tide Water board (SEC Brief, p. 12, fn. 5). The "two-court rule," however, applies not only to the findings of facts of two lower courts but also to all inferences which they reasonably drew from such basic facts. See, e.g., *Graham & Co. v. Locomotive Firemen and Enginemen*, 338 U. S. 232, 235 (1949); *United States v. Dickinson*, 331 U. S. 745, 749 (1947); *United States v. Commercial Credit Co.*, 286 U. S. 63, 67 (1932); Robertson & Kirkham, *supra*, at p. 661. Not only were the inferences drawn by both courts below reasonable, but there is no evidence from which other inferences could have been drawn. Petitioner in effect asks this Court to retry *de novo* both the issue of whether Lehman Brothers used confidential information and also the issue of the design, motive and intent relating to Thomas' election to and service on the Tide Water board. But consistently this

Court has properly refused to perform such a function. As the Court said in *United States v. Yellow Cab Co.*, *supra*, at p. 341:

"Findings as to the design, motive and intent with which men act depend peculiarly upon the credit given to witnesses by those who see and hear them. If defendants' witnesses spoke the truth, the findings are admittedly justified. . . . There is no exception which permits it [the Government], even in an anti-trust case, to come to this Court for what virtually amounts to a trial *de novo* on the record of such findings as intent, motive and design. While, of course, it would be our duty to correct clear error, even in findings of fact, the Government has failed to establish any greater grievance here than it might have in any case where the evidence would support a conclusion either way but where the trial court has decided it to weigh more heavily for the defendants. Such a choice between two permissible views of the weight of evidence is not 'clearly erroneous.'"

## II

### **SECTION 16(b) DOES NOT REQUIRE THE FIRM OF LEHMAN BROTHERS TO ACCOUNT TO TIDE WATER FOR PROFITS REALIZED BY ITS NON-DIRECTOR PARTNERS ON THE SALE OF TIDE WATER STOCK.**

**A. The plain language of Section 16(b) and its legislative history clearly establish that partners of a director are not required to account for "short-swing" profits which they realize.**

Section 16(b) imposes an obligation to account only upon three specific classes of persons, to wit, officers, directors and beneficial owners of 10% of any class of

any equity security of an issuer. The words used by Congress leave no room for the imposition of such an obligation upon other classes of persons. As this Court noted in *United States v. Great Northern Ry.*, 343 U. S. 562, 575 (1952), it is the "judicial function to apply statutes on the basis of what Congress has written, not what Congress might have written." Resort to general legislative purpose is unnecessary when, as in Section 16(b), the meaning of the words chosen by Congress leave no room for reasonable doubt *Ex Parte Collett*, 337 U. S. 55, 61 (1949); *Packard Co. v. N. L. R. B.*, 330 U. S. 485, 492 (1947). But if such resort is made, the legislative history of Section 16(b) establishes that Congress purposely limited liability to officers, directors and 10% shareholders.

Congress enacted Section 16(b) to curb abuses in the trading in securities of an issuer by certain persons who, because of their relationship to that issuer, had access to confidential information. To eradicate such abuses, Congress designated certain classes of persons "insiders" and required them to account for all short-swing profits realized by them, establishing a conclusive presumption that purchases and sales made within a six months period were made on the basis of confidential information. The persons so designated as "insiders" by Congress, namely, directors, officers and 10% stockholders, were those who, because of their relationship to issuers, it could be presumed have access to and act upon the basis of confidential information. Of course, it was argued to Congress that "short-swing" profits can also be realized by persons with no special relationship to an issuer but who, nevertheless, have access to confidential information as a result of their relationship to a particular insider. Hence, Congress was necessarily presented with the question raised in this Court—should a corporation be allowed to recover "short-swing" prof-

its realized by persons other than directors, officers and 10% stockholders who, because of their particular relationship to an insider, actually receive confidential information or who, because of their relationship to insiders, whether it be through marriage, friendship, partnership or other business association, might be presumed to have access to and use such information. Recovery of profits realized by such other persons could logically have been allowed against the insider or against the third party or against both such parties. Congress consciously rejected all three of these alternatives.

Early drafts (H. R. 7852, 73d Cong., 2d Sess. § 15(b), S. 2693, 73d Cong., 2d Sess. § 15(b)) of the provisions which eventually became Section 16(b) provided:

*"(b) It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 percentum of any class of stock of any issuer, any security of which is registered on a national securities exchange \* \* \**

*(3) To disclose, directly or indirectly, any confidential information regarding or affecting such registered security not necessary or proper to be disclosed as a part of his corporate duties. Any profit made by any person, to whom such unlawful disclosure shall have been made, in respect of any transaction or transactions in such registered security within a period not exceeding six months after such disclosure shall inure to and be recoverable by the issuer unless such person shall have had no reasonable ground to believe that the disclosure was confidential or was made not in the performance of corporate duties . . ." (Emphasis supplied)*

The reasons underlying inclusion of subsection (3) were clear. Both the draftsman of the Act and the Con-

gressional Committees which held hearings\* on the Act, understood that the chosen definition of corporate insiders did not include all persons who might realize short-swing profits through the use of confidential information and that subsection (3) was necessary in order to make non-insider recipients of confidential information, whether they be wives, children, friends, partners or business associates of insiders, accountable to a corporation for the "short-swing" profits they realized. Thus, the following colloquy took place between members of the Senate Committee on banking and currency and Mr. Corcoran, chief spokesman for the draftsmen and proponents of the Act:\*\*

"Senator Gore: Would this [present Section 16(b)] prevent him [a corporate fiduciary as defined in the Act] from confederating with someone else, if he were willing to forfeit the profit? His friends on the outside would take the profit resulting from the influences he exercised on the market and then split the pot with him.

Mr. Corcoran: There is an attempt in the next section [15(b) (3)] to catch that?

Senator Carey: Would it be possible for a man to have several people purchase this stock for him?

Mr. Corcoran: There are provisions later to catch his wife and children, as well as trustees for him. There is also a provision in the next section to catch those whom he tips off, and who probably buy

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\*Extensive hearings resulting in testimony and documents of over 10,000 pages preceded the enactment of the Securities Exchange Act of 1934. Five separate bills were introduced, H. R. 7855, H. R. 9323, H. R. 7852, H. R. 8720, S. 2693 and public hearings were held on the latter three over a period of two years. See *Hearings before Committee on Banking and Currency on S. Res. 84, 72d Cong., 2d Sess.*, and *S. Res. 56 and S. Res. 97, 73d Cong., 1st and 2d Sess.*, 1934 *Hearings before Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720, 73d Cong., 2d Sess.*, 1934.

\*\*He was so described by the Second Circuit in its opinion in *Smolowe v. Delendo Corp.*, 136 F. 2d 231 (2d Cir.), *cert. denied*, 320 U. S. 751 (1943).

for his account, and split the profit, insofar as they can be caught.”\*

Mr. Corcoran’s explanation of the need for subsection (3) before the House Committee on Interstate and Foreign Commerce is even more illuminating:

“Now, on page 29, subsection (3), an insider tips off somebody with his inside information, somebody to whom he makes an unlawful disclosure of the secret condition of the company, and the person tipped makes a short swing profit on the stock. The company can sue him for cooperating with the director or with the officer or the stockholder for participating in the profits of the company. That is, the director cannot evade having to turn over his own profit under section 15 by tipping off somebody else to do the job for him, nor can he tip off a friend, or friends, and let them make a killing on inside information at the expense of other people.”\*\*

With this Congressional understanding of the need for and purpose of subsection (3), it was deleted from the bills which eventually passed both the House and Senate and which became the Securities Exchange Act of 1934.\*\*\* As petitioner admits, Congress intentionally omitted this pro-

\*Hearings before the Committee on Banking and Currency on S. Res. 84, 72d Cong., 2d Sess., and S. Res. 56 and S. Res. 97, 73d Cong., 1st and 2d Sess., 6558 (1934).

\*\*Hearings before Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720, 73d Cong., 2d Sess., 135 (1934).

\*\*\*The care with which Congress considered the kind of inhibitions to impose on short-swing transactions is demonstrated by the events preceding the passage of the Act in the House. After extensive hearings on H. R. 7852, a new bill was presented to the House Committee on Interstate and Foreign Commerce by Representative Rayburn (H. R. 8720) in order to meet certain criticisms which had been directed at H. R. 7852 during the course of the hearings (*Hearings*, id. at 625). The new bill, *inter alia*, eliminated subsection (3) from H. R. 7852. The bill which was ultimately passed by the House (H. R. 9323) failed to penalize short-swing transactions at all, other



vision because of its dubious administrative practicality.\*

It is therefore plain that Congress specifically considered and refused a right of recovery to corporate issuers for those "short-swing" profits realized either by third parties to whom insiders actually disclosed confidential information or by third parties who might have special access to confidential information by reason of their particular relationship to insiders. There is no room for speculation as to Congressional intent in the context of the instant case; indeed, it appears obvious that petitioner is requesting this Court to extend the statute to provide what Congress explicitly considered and rejected. "In our anxiety to effectu-

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than "short sales", and it was only after the Conference Committee agreed to the Senate version of the bill that the House agreed to the penalties now set forth in Section 16(b). See Conference Report Accompanying H. R. 9323, H. R. Rep. No. 1838, 73d Cong., 2d Sess. 35 (1934).

\*The following colloquy, which took place during the course of the House hearings, is only one of many which indicates the Congressional dissatisfaction with enacting a provision, the enforcement of which was impractical:

"Mr. Wolverton: . . . [H]ow are you going to catch anybody?

\* \* \*

Mr. Corcoran: Sir, in the great majority of cases in which that occurs, you are never going to find it out, but is it not worth while to get those cases where you can find it out, you want to catch them even if you cannot catch all of them.

Mr. Wolverton: But, with this bill before us in an effort to regulate the stock exchanges, and eliminate certain evils, I would like for you to give us an example as to how it is to be done. I am interested in the practical side of it and not the theoretical side. I am not in favor of just putting words into a bill without giving serious consideration to their effectiveness.

Mr. Corcoran: You will catch a few of them, and the fact that the risk of being caught, even if that is only a small risk, will act as a deterrent in a great many cases.

Mr. Wolverton: It would seem to require considerable optimism to expect this provision in the bill to be more effective



ate the congressional purpose of protecting the public, we must take care not to extend the scope of the statute beyond the point where Congress indicated it would stop." 62 *Cases of Jam v. United States*, 340 U. S. 590, 593, 600 (1951). Petitioner's continued reference to the general purpose of the statute is irrelevant since Congress has manifested a considered legislative judgment upon the question presented here. See *Fourco Glass Co. v. Transmirra Prods. Corp.*, 353 U. S. 222, 228 (1959); *MacEvoy v. United States*, 322 U. S. 102, 107 (1944); *Ginsberg & Sons, Inc. v. Popkin*, 285 U. S. 204, 208 (1932).

This view of the legislative history of Section 16(b) has not only been confirmed by both courts below in this case but by every other court which had occasion to consider it. See e.g., *Smolowe v. Delendo Corp.*, 136 F. 2d 231 (2d Cir.) *cert. denied*, 320 U. S. 751 (1943); *Rattner v. Lehman Brothers*, 193 F. 2d 564 (2d Cir. 1952).

In *Smolowe v. Delendo Corp.*, *supra*, Judge Clark stated:

"Furthermore, provisions in these early drafts declaring unlawful the improper disclosure of confidential information regarding securities by directors, officers, or principal stockholders, and holding

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than the Prohibition Enforcement Act. Do you have such optimism?

Mr. Corcoran: Yes; I suppose I have.

Mr. Wolverton: Well, that act has certainly shown the utter futility of attempting to enforce a provision of this kind. It seems to me that this provision might be even more difficult.

\* \* \*

Mr. Corcoran: No. Suppose a man is very close to the inside of a corporation, and there is circumstantial evidence turning up, for instance, in tax returns, or otherwise that he did buy stock just before a lift and sold out within 6 months, and that he was very, very close to a certain officer, or director of the company. That might be enough to prove a case against him.

Mr. Wolverton: My optimism is not as good as yours."

(Hearing before the Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720, 73d Cong., 2d Sess. pp. 135-138 (1934)).

that any profit made by any person to whom such unlawful disclosure was made should inure to the corporate issuer, were deleted, presumably because the burden of proof made enforcement unfeasible." (136 F. 2d at 236).

The Court of Appeals for the Second Circuit held in circumstances identical to those here present, that Section 16(b) does not require a partnership to account for the "short-swing" profits realized by it from trading in the equity securities of an issuer merely because one of the firm members was a director of the issuer. *Rattner v. Lehman, supra*. The court in that case rested its opinion squarely upon the ground that "the legislative history indicates that the omission of any provision for such liability [the accountability of a director's partners for profits realized by them] was intentional" (193 F. 2d at 566), while noting that a "literal" reading of Section 16(b) required the same result.

Following the decision in *Rattner* the Securities and Exchange Commission amended its Rule X-16A-3, which is one of the regulations implementing the reporting requirements of Section 16(a). Until November 1, 1952 the rule required a partner-director to report only that amount of the equity securities of his corporation held by his partnership which represented his proportionate interest in the partnership. As amended November 1, 1952 the rule required a partner-director thereafter to report the entire amount of the equity securities held by the partnership but it gave him the option "... if he so elects, [to] disclose the extent of his interest in the partnership ..." Securities and Exchange Commission Release No. 4754 (September 24, 1952),\* explains the purpose of the amendment in the following language:

"... The new rule X-16A-3 requires any person who is a member of a partnership which owns securities of an issuer of which he is an officer, director, or ten per cent stockholder to report all holdings and all changes in the beneficial ownership of equity securities of that issuer held by the partnership. *It is not intended as a modification of the principles governing liability for short-swing transactions under section 16(b) as set forth in the case of Rattner v. Lehman*, 193 F. 2d 564. . . ." (Emphasis supplied)

The Commission, which is primarily responsible for administering the Act and, under Section 23(b) of the Act, for recommending remedial legislation, specifically informed Congress of the holding of the *Rattner* case in its Seventeenth and in its Eighteenth Annual Reports to Congress. *Seventeenth Annual Report of the Securities and Exchange Commission*, p. 62 (1952); *Eighteenth Annual Report of the Securities and Exchange Commission*, p. 79 (1953). In neither of these reports nor in any subsequent ones did the Commission ever voice any dissatisfaction with the *Rattner* opinion or recommend legislation to cure defects resulting from the Second Circuit's interpretation of Section 16(b). Not until the present time has the Commission indicated any doubts as to the correctness of the interpretation of Section 16(b) contained in *Rattner*. During a period of nearly thirty years since the passage of the Act, it has not sought to impose liability upon third party recipients, or potential recipients, of inside information, whether they be relatives, partners, or business associates of an insider. See *United States v. Leslie Salt Co.*, 350 U. S. 383, 396 (1956); *FTC v. Bunte Bros., Inc.*, 312 U. S. 349 351-52 (1941).

the results of the *Rattner* litigation, Congress failed to take any action to remedy the alleged consequences of the *Rattner* result. This in itself is persuasive evidence that both *Rattner* and the identical result below were in accordance with Congressional intent. *Toolson v. New York Yankees, Inc.*, 346 U. S. 356 (1953); *United States v. Elgin, J. & E. Ry.*, 298 U. S. 492, 500 (1936).

Neither *Rattner* nor the decision below carve out an exception to a uniform judicial interpretation of Section 16(b) as "broadly remedial". The cases relied upon by petitioner (Pet. Brief, p. 17-19) merely hold that the remedial purpose of Section 16(b) is broad enough to strike down any means by which *admitted insiders* realize "short-swing" profits; they did not deal with the question of whether or not a particular person was an insider. Since it has been consistently recognized that Congress deliberately limited Section 16(b), it is not respondents but petitioner who would have this Court carve out an arbitrary exception to a long recognized and accepted interpretation of Section 16(b).

Nor did *Rattner* or the decision below carve out an exception to the rule that liability under Section 16(b) does not require a showing of an actual use of inside information. While it is true that both courts below found that Thomas did not disclose any confidential information and that the purchase and sale were made by Lehman Brothers without the advice or concurrence of Thomas, they specifically held, as did *Rattner*, that partners of a director are not accountable for profits they realize whether or not there was disclosure of confidential information.

In construing Section 16(b) it must be remembered that the section is woven from a delicate fabric of presumptions. The constitutionality of the imposition of an absolute liability upon Congressionally designated insiders has been sustained on several occasions primarily on the ground that

there were Congressional findings that the persons within the specified classes normally do have access to confidential information and do act on the basis of such information. Thus the imposition of an absolute liability on such persons was held to be a reasonable remedial solution. *Smolowe v. Delendo Corp.*, *supra*. Now to argue, in the absence of comparable legislative findings, that this absolute liability should be extended to other persons, would pose serious constitutional questions. Cf. *Tot v. United States*, 319 U. S. 463 (1943).

Petitioner suggests no rational formula for determining what additional categories of persons should be held accountable for "short-swing" profits by reason of their relationship to "insiders". There is some suggestion in the brief of the Commission that it would limit such accountability to partners of a director, but only when the partnership is engaged in the business of investment banking.\* No reason or statutory basis for the extension of the statute to this limited group is suggested.

For one thing, the principals of an investment banking concern which does business in the corporate form have the same access to confidential information if one of them serves as a director of an issuer as does a partnership where one of the partners is a director of an issuer. For another, the possibility of mutual exchange of confidential information is just as possible if the partnership were engaged in the practice of law, accounting, or engineering, since the partners in these firms are in frequent contact and obviously share common business interests. As a matter of fact, accessibility to confidential information exists just as often, or

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\*At page 12 of its brief (footnote 4) the Commission states that investment banking firms are "customarily organized as partnerships". A perusal of the list of defendants in *United States v. Morgan*, 118 F. Supp. 621, 625-6 (S. D. N. Y. 1953), reveals that seven of the seventeen leading investment banking firms were organized as corporations.

more often, where a relationship between an insider and a third party results from marriage, consanguinity or friendship. It is clear, therefore, that whatever access a partnership may have to confidential information because one of the partners is an insider is unrelated both to the activities in which the partnership is engaged and to the choice of the partnership form of organization rather than some other form of business entity.

No matter how put, petitioner's argument is no more than that this Court should judicially impose liability upon certain groups of potential recipients of confidential information because of their relationship, not to an issuer, clearly the standard followed by Congress, but because of their relationship to an insider. That Congress purposely limited the remedial scope of Section 16(b) so as to include "short-swing" profits realized only by those persons specified in that section clearly emerges both from the plain meaning of the words chosen and the legislative history. The Congressional mandate does not permit the roaming at large urged by petitioner.

#### **B. Lehman Brothers Was Not a Director of Tide Water**

Statutory liability under Section 16(b) can be imposed only on persons designated as insiders by that section. Petitioner has attempted to conform to this legislative reality at one place in his brief by characterizing the entire firm of Lehman Brothers as a director of Tide Water (Pet. Brief pp. 34-35). Apparently it was Lehman Brothers' "access to confidential information" (Pet. Brief p. 35) that elevated it to directorship status. But this argument is based on the very same ground as petitioner's attempt to have this Court disregard the clear legislative history of Section 16(b) and to extend its scope to reach individuals or categories of individuals not enumerated in the Act solely because of the alleged use of, or access to, confidential information.



A partnership is defined as a "person" in Section 3(a)(9) of the Act. The relevant question, however, is whether such a person is a director. Congress defined the term director in Section 3(a)(7) of the statute to mean:

"... any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated. (15 U. S. C. § 78c(a)(7))

A *sine qua non* of directorship status under Section 16(b) is, therefore, that the alleged director is actually performing the functions of a director for the issuer.

The requirement that duties be performed is identical to a similar requirement in the Commission's Rule 3b-2 which defines officer as:

"... any other person *who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers.*" (Emphasis added)

This similarity is noted in *Lockheed Aircraft Corp. v. Rathman*, 106 F. Supp. 810, 813 (S. D. Cal. 1952), and in 2 Loss, *Securities Regulation* 1095 (2d ed. 1961). Petitioner has misinterpreted the statements of the court in the only case cited by him to support the proposition that Lehman Brothers was itself a director because of its possible access to information. In ascertaining whether an employee was an "officer" for the purpose of Section 16(b), the court, in *Colby v. Klune*, 178 F. 2d 872 (2d Cir. 1949), although expanding the definition of officer beyond that contained in commission Rule 3b-2, indicated that it is essential that the employee perform important executive duties before he can be deemed an officer under the statute:

"... we construe 'officer,' as used in Section 16(b) of the Securities Exchange Act, thus: It includes,



*inter alia*, a corporate employee performing important executive duties of such character that he would be likely, in discharging these duties, to obtain confidential information about the company's affairs that would aid him if he engaged in personal market transactions. It is immaterial how his functions are labelled or how defined in the by-laws, or that he does or does not act under the supervision of some other corporate representative." (178 F. 2d at 873; footnotes omitted).

Thus, access to confidential information in itself is not enough, even under *Colby v. Klune*, to constitute a person an officer. The Commission has rejected the relevance of access to confidential information in determining officership status, because such an approach would lead to "undue uncertainties", and the SEC continues to utilize the purely functional approach embodied in Rule 3b-2. Securities Exchange Act of 1934, Release No. 4754 (September 24, 1952).

The record of this case does not contain a scintilla of evidence nor does petitioner now suggest that Lehman Brothers, or any of its partners other than Thomas, ever performed any director functions for Tide Water or, indeed, ever performed any services for Tide Water at all except in their capacity as investment bankers. Unable to meet the evidentiary requirements of Section 3(a)(7), petitioner argues that Lehman Brothers is a director because of some alleged representation by Thomas. Petitioner has not explained how "representation"—even if proved—can be equated with the statutory requirement that directors' functions be performed.

Perhaps in a situation where a "dummy" director represents shareholders and casts votes which represent the group's view, then it could be argued that the real owners are, through this "deputation", performing the function

of a director. In such a case it would, of course, seem to be necessary to show that those represented actually made the decisions on various subjects, which were carried out by the ostensible director. There is no evidence in the record that Thomas was a "dummy" director, or that Lehman Brothers dictated to Thomas as a director; and the findings of fact so state. Petitioner did not even attempt to introduce evidence that would indicate that Thomas consulted his partners before casting votes as a director or that Lehman Brothers in any way attempted to influence his vote. Thomas' uncontroverted testimony was that he would have considered it highly improper to consult the Lehman Brothers partners on Tide Water matters being considered by the latter's Board of Directors (R. 34a, 56a). As was stated in *Gilman v. Jack*, 148 Me. 171, 91 A. 2d 207 (1952), a case refusing to hold a director a "representative" of certain investment bankers for purposes of the Public Utility Holding Company Act, 15 U. S. C. § 799(c):

"There is no evidence that he owed any express or implied duty to them to support or carry out their views. Nor is there any evidence that he was not to exercise his own independent judgment as to what would be for the best interests of the corporation in any of his acts as director thereof. On the other hand, the right of entire freedom of action on his part, as such director, is clearly established. Under such conditions the sitting justice properly found as as matter of law that he was not an appointee or representative of investment bankers within the meaning of section 17(c), *supra*." (91 A. 2d at 208-209).

Petitioner argues that Thomas represented (a term not appearing in Section 16) Lehman Brothers because he might have been instrumental in obtaining some underwriting business for that firm. The fact of the matter is that Lehman Brothers obtained no financial business from Tide

Water during Thomas' tenure on the board prior to the institution of this action (R. 17a, 1a). Moreover, there is no proof in the record that Lehman Brothers' participation in the underwriting group in the 1956 Tide Water offering of securities (R. 17a) resulted from Thomas' directorship.

Even had petitioner been able to prove that Thomas' presence on the board had helped Lehman Brothers maintain cordial relations with Tide Water, there is no logical nexus between cordial relations and the imposition of Section 16(b) liability.

Unable to meet the statutory requirement that he prove that Lehman Brothers performed the functions of a director, and unable to prove that Thomas represented Lehman Brothers on the Tide Water Board, petitioner points to a comment in a concurring opinion by Judge Learned Hand in the *Rattner* case. In that opinion Judge Hand said:

"\* \* \* and the only question is whether partners are liable for whatever profits the firm may make, whenever one of their members is a director, and only because he is a director. I agree that § 16(b) does not go so far; but I wish to say nothing as to whether, if a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable. True, they would not even then be formally 'directors'; but I am not prepared to say that they could not be so considered; for some purposes the common law does treat a firm as a jural person. The provision eliminated from the earlier drafts of the Act does not seem to me to throw any light at all on such a situation as that." (193 F. 2d at 566-67).

Petitioner has not explained how a deputor's liability fits into the statutory scheme of Section 16(b). The Commission would eliminate the obscurity of the deputing concept with its assertion that there need be no "formal deputization" and therefore no need to prove that a "partner was

installed as a director to aid his partnership or that he transmitted inside information to his associates." [SEC Brief, p. 18] Thus, the Commission would eliminate the "if" clause from Judge Hand's comment and would distort it to reach the very result that he explicitly rejected—that the fact of partnership alone constitutes a basis for Section 16(b) liability.

It is apparently petitioner's position that the word "deputing" relates to the partnership's role in the selection of a director rather than its and his activities during his tenure of office. Whatever the chronological limits of the word, it should be noted that in this case, the first case where deputing was specifically alleged, Judges Medina and Swan, in the decision below, concluded that they could "not see how any sort of deputizing can make the partners or the partnership a 'director' within the meaning of Section 16(b)" (R. 179).

In this case, the District Court found, and the Court of Appeals agreed, that there was "no evidence of any deputizing" (R. 179) and that "the evidence in this case will not support an inference that Lehman Brothers deputized Thomas to represent its interests as director on the board of Tide Water" (R. 179). The District Court found and the Court of Appeals reiterated that "The invitation to join the Tide Water Board was upon the initiative of Tide Water" (R. 150a, 176, 180). Such invitation was extended to Thomas personally, not to Lehman Brothers. Thomas accepted because of his interest in the oil business and because of the prestige factor in serving on the board of a large corporation (R. 150a). In fact, found the District Court, "the interests of Lehman Brothers in Tide Water at the time Thomas was elected to be a director were minimal" (R. 153a).

Since these findings were concurred in by both courts below, for the reasons stated in Point I, *supra*, they should not be disturbed. Lack of evidence in the record cannot be

cured by reference to circumstances surrounding the election of another director twenty years earlier or the procedure followed in selecting directors of other corporations.\* Petitioner's attempt to cure evidentiary deficiencies by citing factual findings from prior cases involving the same defendant but different plaintiffs violates fundamental principles of collateral estoppel and ignores the differences between the statutes involved. Petitioner, for example, places strong reliance on *Lehman v. Civil Aeronautics Board*, 209 F. 2d 289 (D. C. Cir. 1953), *cert. denied*, 347 U. S. 916 (1954). But the issue in that case was not whether liability should have been imposed on Lehman Brothers because it was a "director" but whether one partner of Lehman Brothers was required to obtain Civil Aeronautics Board approval to act as a director of a common carrier because he could be considered a "representative" of another partner within the meaning of the Civil Aeronautics Act. The word "representative" does not appear in Section 16 of the Securities Exchange Act of 1934. Its use in the Civil Aeronautics Act, moreover, indicates that Congress knows how to embody the concept of representation in a statute when it so desires.

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\*At page 5 of his brief petitioner states that he offered to prove that the election of Thomas to the Tide Water board was the fruition of a pre-conceived plan. The offer of proof consisted of petitioner's notice to admit and the responses thereto.

Lehman Brothers, in response to plaintiff's request for admissions, admitted that members of the firm have from time to time served as directors of various corporations, and that the firm in certain instances acted as underwriter along with others in the issuance of securities of a corporation while a member of the firm served as a director of the issuer. That members of Lehman Brothers have in the past served as corporate directors is by itself, of course, a neutral fact. And even when coupled with the fact that Lehman Brothers has performed financial service for such corporations, these admissions have no probative value because they are susceptible of many inferences, the most probable of which is that Lehman Brothers was chosen to render financial services because it is one of the large, experienced underwriting firms participating in a very large number of underwritings.

When Congress was concerned with remedying insider trading abuses it was perfectly able expressly to extend the statutory proscription to partners. Section 30(f) of the Investment Company Act of 1940 (15 U. S. C. § 80a-29(f)) makes Section 16(b) applicable to a person who is an "officer, director, member of an advisory board, investment adviser, or affiliated person of an investment adviser" of an investment company.\* "Affiliated person is defined in Section 2(a)(3)(D) of the Investment Company Act (15 U. S. C. § 80a-2(a)(3)(D)) as, *inter alia*, "any officer, director, *partner*, copartner or employee of such other person. . . ."\*\* (emphasis added) It would have been simple enough similarly to include partners of named insiders in the Securities Exchange Act of 1934.

A further example is found in § 17(c) of the Public Utility Holding Company Act, 15 U. S. C. § 79q(c). Section 17(b) of that Act (15 U. S. C. 79q(b)), which is vir-

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\*"(f) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of outstanding securities (other than short-term paper) of which a registered closed-end company is the issuer or who is an officer, director, member of an advisory board, investment adviser, or affiliated person of an investment adviser of such a company shall in respect of his transactions in any securities of such company (other than short-term paper) be subject to the same duties and liabilities as those imposed by section 78p of this title upon certain beneficial owners, directors, and officers in respect of their transactions in certain equity securities. Aug. 22, 1940, c. 686, Title I, § 30, 54 Stat. 836."

\*\*\*"(3) 'Affiliated person' of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof."



tually identical to Section 16(b) of the 1934 Act, makes no mention of the words partner or representative. Yet, the immediately following section, (Section 17(c), 15 U. S. C. 79q(c)), provides that no registered holding company shall have as an officer or director "any executive officer, director, *partner*, appointee, or representative of any bank, trust company, *investment banker* . . ." (emphasis added).<sup>\*</sup> The juxtaposition of Section 17(b) and 17(c) clearly demonstrates that Congress deliberately omitted any reference to partners in the insider trading provisions of both Section 17(b) of the Public Utility Holding Company Act and Section 16(b) of the Securities Exchange Act of 1934.

Petitioner's reliance on the trustees' compensation provisions of the Bankruptcy Act is misplaced. The legislative history of Section 16(b) establishes that Congress considered and rejected the liability here contended for. Unlike Section 16, Section 249 of the Bankruptcy Act<sup>\*\*</sup> was not a carefully limited departure from prior law but merely a codification of the power already exercised by the courts under their general equitable power over compensation.

"In the absence of statute, a court has the long established discretion to determine and regulate compensation of those acting in a fiduciary capacity under its direction." *In re Central States Electric Corp.*, 112 F. Supp. 281, 287 (E. D. Va.), *leave to*

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<sup>\*</sup>"(c) After one year from August 26, 1935, no registered holding company or any subsidiary company thereof shall have as an officer or director thereof, any executive officer, director, *partner*, appointee, or representative of any bank, trust company, investment banker, or banking association or firm, or any executive officer, director, partner, appointee, or representative of any corporation a majority of whose stock, having the unrestricted right to vote for the election of directors, is owned by any bank, trust company, investment banker, or banking association or firm, except in such cases as rules and regulations prescribed by the Commission may permit as not adversely affecting the public interest or the interest of investors or consumers. Aug. 26, 1935, c. 687, Title I, § 17, 49 Stat. 830." (Emphasis supplied)

<sup>\*\*</sup>11 U. S. C. § 649.



*appeal denied*, 206 F. 2d 70 (4th Cir.), *cert. denied*, 346 U. S. 899 (1953).

See Senate Report No. 1916 on H. R. 8046, 75th Cong., 3d Sess., 38 (1938). See also, 6 *Collier, Bankruptcy* ¶ 13.18 at p. 4585, (Moore ed. 1947). *Berner v. Equitable Office Building Corp.*, 175 F. 2d 218, 219 (2d Cir. 1949). Moreover, Section 249 utilizes more sweeping language than that incorporated in Section 16(b). See *Surface Transit, Inc. v. Saxe, Bacon & O'Shea*, 266 F. 2d 862, 868 (2d Cir.), *cert. denied*, 361 U. S. 862 (1959); *Nichols v. SEC*, 211 F. 2d 412, 417 (2d Cir. 1954).

Similarly inapposite are common law cases based upon proven breaches of fiduciary duty. Common law concepts of liability (which apply only after an actual breach of duty has been adjudicated) are irrelevant in a Section 16 action since that section was specifically designed to obviate the necessity of proving breaches of fiduciary duty. In fact, petitioner specifically asserted that he was not relying on common law liability (R. 28a, 29a, 147a).

In sum, the pertinent question here is not whether it is "reasonable" to treat Lehman Brothers as a director (SEC Brief, pp. 16-17) but whether anything in the Securities Exchange Act of 1934 imposes liability on Lehman Brothers under the circumstances of this case. Actually, the position of both petitioner and the Commission is simply that under their view of public policy the Lehman Brothers' partners ought to be held liable because of a supposed access to confidential information. Since the logical route to achieve this goal is foreclosed because Congress designated the categories of persons who, it could be presumed, act on the basis of confidential information, they have attempted to achieve the same end by expanding the concept of "director" and thus accomplish by indirection what they could not do directly. Petitioner and the Commission are unhappy be-

cause Congress drew a clear though arbitrary line defining the persons who would be subject to Section 16, and they have now turned to the courts to cure Congress' "illogical" position. This attempt to rewrite the statute cannot be accomplished by reference to the niceties of state partnership law or by elaborate description of how investment bankers operated in the 1920's. Furthermore, even where petitioner has attempted to construct legal doctrines which would impose liability without amending the statute he has wholly failed to establish any facts which would support those doctrines. On the law and on the facts the partners of Lehman Brothers cannot be held liable under Section 16.

### III

#### **THE COURTS BELOW CORRECTLY HELD THAT THOMAS WAS NOT LIABLE FOR MORE THAN HIS PRO-RATA SHARE OF THE PROFITS.**

Section 16(b) of the Act imposes liability upon a director only for "any profit realized by him" from certain specified transactions. The statutory mandate is clear, and the legislative history noted above demonstrates, that Congress was perfectly aware that an insider would not be liable under Section 16(b) for profits realized by third persons to whom he disclosed confidential information (*supra*, pp. 18-20). Yet, Congress not only added no such remedy but specifically deleted a provision from Section 16(b) which would have made it unlawful for insiders to disclose confidential information (*supra*, p. 18). Congress specifically refused to impose the "deterrent" now sought by petitioner.

Thomas was entitled to approximately 4% of the firm's profits under the partnership agreement (R. 123a). The courts below held that he could not waive his 4% interest in the profits of the Tide Water transaction so as to escape

liability to the issuer for that amount under Section 16(b) since by transferring his share of the profits to his partners he exercised such dominion over those profits as to "realize" them within the meaning of the Act (R. 155a, 182). Thomas at no time, however, was entitled to, nor did he share in, nor did he exercise control over the remaining 96% of the profits which belonged to the other members of the firm (R. 111a-121a).

It was apparently the theory of the dissenting judge below, now reiterated by petitioner, that Thomas should be held accountable for all the profits realized by Lehman Brothers because he purportedly was "co-owner with all the other partners of the Tide Water stock when bought and of the profits when sold" (R. 187). Under the Act, however, co-ownership is not the operative event creating liability—under the Act, Thomas can be held accountable only for profits realized by him.\* Petitioner has equated "co-ownership" of partnership property with "realization" of partnership profits. This theory is premised on a misunderstanding of the applicable partnership law.

First, Thomas never co-owned the preferred stock, the purchase and sale of which is here in issue, because, prior

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\*The dissenting judge below argued that each partner was the co-owner with all the other partners of the Tide Water stock and that each partner should be treated as the owner of all the Tide Water stock. Section 16 of the Act speaks only of "beneficial ownership", a basis of liability not alleged in this case. Moreover, the Commission itself has recognized that a partner "owns" only his proportionate share of the securities of an issuer owned by his partnership. An opinion of the General Counsel of the Commission, appearing in Release No. 79 which was reprinted in Release No. 1965, December 21, 1938, 11 F. R. 10971, states that an individual partner who is not a director is not required to file reports as a 10% holder of the equity securities of an issuer unless his proportionate share of the firm's holdings exceeds 10% or, coupled with his other holdings of the same security, exceeds 10%. And Commission Rule 16a-10 exempts any transaction from the provisions of 16(b) which has been exempted from the reporting requirements of 16(a).

to such acquisition, he and his partners agreed to a modification of the partnership agreement which excluded him from any interest in the stock (R. 122a-123a).<sup>\*</sup> Moreover, even if he were considered the co-owner of such stock, it is perfectly clear that under New York partnership law he was not the owner or the co-owner of the profits realized by other partners of Lehman Brothers. Section 52 of the New York Partnership Law specifically provides that:

“A partner’s interest in the partnership is his share of the profits and surplus . . . .”

Thus, rather than acquiring an “indivisible” interest in all of the profits realized by members of a partnership (Pet. Brief, p. 45), a partner’s interest in the firm’s profits is his specific share as set by the agreement.<sup>\*</sup> The concept of co-ownership in partnership law has reference only to a partner’s interest in the partnership’s specific property and not to his share in the profits, and principally serves to place such assets beyond the reach of creditors of the individual partner. See *N. Y. Partnership Law*, § 51(2)(c).

If petitioner’s view of New York partnership law as creating in each partner an “indivisible” interest in all the firm’s profits were correct, then a creditor of Mr. Thomas could have attached or seized his partners’ shares of the firm profits to satisfy Mr. Thomas’ debt. Section 915-a of the New York Civil Practice Act, however, makes it clear that Thomas owned only his share of the profits (as opposed to the partnership property) realized by the firm, and thus only his share of the profits is subject to attachment by his creditors:

“The court which granted the warrant of attachment . . . may . . . appoint a receiver of the *defendan-*

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<sup>\*</sup>Section 40 of the New York Partnership Law provides that the relationship between partners shall be governed by the agreement between them.

ant's share of the profits, and of any other money due or to fall due to him in respect of the partnership. . . ." (Emphasis supplied).

That Thomas did not himself "realize" profits received by the other members of the firm is also demonstrated by provisions of the Internal Revenue Code. If such were not the case, then each partner would be taxed upon all the profits of the firm because the concept of realization as the touchstone of taxability has long been embodied in the tax law. *Helvering v. Horst*, 311 U. S. 112 (1940). But there can be no doubt that for tax purposes Thomas did not "realize" his partners' profit from the Tide Water transaction since each partner was required to pay taxes only on his distributive share of the profits. *Int. Rev. Code of 1954*, Section 702.

The Court of Appeals, in the *Rattner* case, refused to impose the liability on the defendant-director now sought (193 F. 2d at 565). The Court there held that the partner-director was not liable for any of the profits received by the other members of the firm.

Petitioner argues that this holding in *Rattner* turned upon the partner-director's lack of knowledge of the purchase and sale involved in that case. He further argues, based upon a suggestion in *Rattner*, that in the instant case liability upon Thomas for all the profits of the partnership should be imposed because soon after the first purchases were made, Thomas became aware of the firm's purchases of Tide Water common stock (R. 49a-50a). However, the significant factor justifying the imposition of such liability on the partner-director, according to this suggestion, is not knowledge but whether the partner-director "caused" the firm to make the short-swing transaction. In *Rattner* the court reasoned that since the partner-director was without

knowledge of the purchase and sale he could not have advised or caused the firm to enter such transaction (193 F. 2d at 565). While petitioner in this case argues that Thomas caused the purchase and sale of Tide Water stock, the evidentiary facts are to the contrary—and both the District Court and the Court of Appeals so found (see *supra*, p. 9). Moreover, the legislative history, (*supra*, pp. 18-20), demonstrates that Congress refused to impose liability upon a director, or any other insider, because he caused a third party to realize "shortswing" profits.

Petitioner and the Commission seek to analogize this case to the case of *Walet v. Jefferson Lake Sulphur Co.*, 202 F. 2d 433 (5th Cir.), *cert. denied*, 346 U. S. 820 (1953). In that case, the defendant-director purchased and sold securities of his company within a six months period. When the corporation instituted suit under Section 16(b), the defendant-director sought to defend on the ground that only one-half of the profits had been realized by him, the other one-half having been allegedly realized by his wife by virtue of the community property laws of Louisiana. The Court of Appeals for the Fifth Circuit rejected this defense on the ground that "the husband, under the law of Louisiana, is the head and master of the community and as such must be held accountable for his management thereof to the same extent as if it were his own" (202 F. 2d at 434). Thus the *Walet* decision is clearly inapposite here, as the Commission concedes in a footnote (SEC Brief, p. 20 n. 10), as a partner has neither the right, responsibility or duty of controlling the profits realized by his partners. See *Opin. of Gen. Coun. of S. E. C.*, Release No. 175, 11 F. R. 10968, Apr. 16, 1935, describing those circumstances under which a husband would be deemed the owner of securities registered in his wife's name.

Petitioner further argues that the amendment of Commission Rule X-16A-3(b) in 1952 requires re-evaluation of



the *Rattner* decision insofar as it limits recovery against the partner-director to his share of the profits. This argument is also based on a false premise. First, the rule relates only to the reporting requirements of Section 16(a) of the Act. Second, the Act nowhere authorizes the Commission to create a substantive liability under Section 16(b) which Congress refused to impose. And, finally, in the Commission's own words, the rule was

*"... not intended as a modification of the principles governing liability for short-swing transactions under section 16(b) as set forth in the case of Rattner v. Lehman, 193 F. 2d 564. ..."* (Emphasis supplied) S. E. C. Release No. 4754 (Sept. 24, 1952)

The express words of Section 16(b) make it clear that Congress has imposed liability on a director only for profits realized by him. It has not imposed any added liability upon a partner-director for causing others to purchase; it has not imposed a liability upon a partner-director for profits realized by other persons—whether they be his partners, his relatives, his friends or business associates. To impose upon Thomas the liability here contended for would require this Court to ignore the plain meaning of the statute, and its legislative history. "It is for [this court] to ascertain—neither to add nor to subtract, neither to delete nor to distort". *Flemming v. Florida Citrus Exchange*, 358 U. S. 153, 166 (1958). If the welfare of society requires that a director pay an issuer the profits realized not by him but by others, it is for Congress to expand the penalty to be exacted. The judgment as to Thomas must be affirmed.



## IV

**THE COURT OF APPEALS PROPERLY HELD THAT THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN NOT ADDING INTEREST TO THE JUDGMENT AGAINST THOMAS.**

Authority for the addition of interest to the judgment against Thomas from the date of sale to the date of judgment must be found, of course, in Section 16(b) of the Securities Exchange Act of 1934. Cf. *Rodgers v. U. S.*, 332 U. S. 371 (1947). In *Board of Commissioners v. United States*, 308 U. S. 343 (1939), the court pointed out:

"The cases teach that interest is not recovered according to a rigid theory of compensation for money withheld, but is given in response to considerations of fairness. It is denied when its exaction would be inequitable." (308 U. S. at 352).

Speaking with regard to a judgment under Section 16(b), it has held that an allowance of interest from the time of realization of profit is not mandatory. *Magida v. Continental Can Co.*, 231 F. 2d 843, 848 (2d Cir.), cert. denied, 351 U. S. 972 (1953).

In the instant case, there are compelling reasons not to award interest to petitioner. Initially it must be noted that the amount of profits found by the District Court to have been realized by Lehman Brothers is a completely artificial figure which exceeds by more than three times the actual profit realized by the firm (See n. *supra*, p. 9). To award interest on Thomas' proportionate share of such profits would be penal and would transcend the remedial purpose of the Act. It must also be noted that Thomas himself did not receive any part of the \$30,386.77 actually realized by the firm (*supra*, p. 10). To compel Thomas to pay

interest on sums never received or withheld by him would be inequitable in the extreme.

The question of whether or not to award interest was within the discretion of the District Court. The refusal to award interest in the circumstances here present was not an abuse of that discretion.

### CONCLUSION

This Court should not disregard the findings below nor should it add a fresh category to those selected by Congress who must account for insider profits. The judgment below was clearly correct and should be affirmed.

Respectfully submitted,

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Office Supreme Court, U.S.  
FILED

OCT 19 1961

JOHN F. DAVIS, CLERK

IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1961

No. 66

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

*Petitioner,*

—against—

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRLMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of Lehman Brothers, JOSEPH A. THOMAS, and TIDE WATER ASSOCIATED OIL COMPANY,

*Respondents.*

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS  
FOR THE SECOND CIRCUIT

**MOTION OF AMERICAN SOCIETY OF CORPORATE  
SECRETARIES, INC., FOR LEAVE TO  
FILE BRIEF AMICUS CURIAE.**

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September 18, 1961.

IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1961

ISADORE BLAU,

*Petitioner,*

—against—

ROBERT LEHMAN, ET AL.,

*Respondents.*

No. 66

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS  
FOR THE SECOND CIRCUIT

**MOTION OF AMERICAN SOCIETY OF CORPORATE  
SECRETARIES, INC., FOR LEAVE TO  
FILE BRIEF *AMICUS CURIAE*.**

*To the Honorable the Chief Justice and the Associate  
Justices of the Supreme Court of the United States:*

American Society of Corporate Secretaries, Inc. (hereinafter called the Society) respectfully moves the Court for leave to file the attached brief *amicus*. The attorneys for all respondents appearing here have consented to such filing.\* The attorney for Petitioner has declined to give such consent. The Securities and Exchange Commission (hereinafter called the Commission) has filed a brief *amicus* in support of Petitioner.

The Society is a New York membership corporation. Approximately 1,250 Secretaries and Assistant Secretaries

\*Tide Water Associated Oil Company, a nominal defendant in the District Court, has not appeared here and its consent has not been sought.

**Motion**

of many of the principal corporations of the United States are members. Many of such members are also Vice-Presidents, General Counsel or Treasurers of such corporations. More than half of the corporations whose securities are listed on the New York Stock Exchange are represented in the Society.\*

Many members of the Society are personally subject to Section 16(b) of the Securities Exchange Act of 1934 (hereinafter called the Act)\*\*, with which this litigation is concerned. Further, the Society's members, because of the nature of their positions, are directly and daily concerned with problems arising under Section 16(b). They are the persons who must try to answer, as best they can, the questions of their superiors and fellow executives as to what Section 16(b) means.

Section 16(b) was presented to Congress, and adopted, as a "crude rule of thumb"\*\*\* to prevent the unfair use of inside information. It was to apply to any purchase and sale, or sale and purchase, within a six-month period of any equity security of a corporation having securities listed on a stock exchange. Any 10% stockholder, director or officer of such a corporation was to be liable for profits "realized by him" in short-swing transactions in the equity securities of his company. Congress rejected a proposal to apply the Section to persons to whom such "insiders" passed on information.†

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\*None of the parties before this Court is a member of the Society. The Secretary of Tide Water is a member.

\*\*48 Stat. 881 (1934), 15 U. S. C. § 78 (1958).

\*\*\*Testimony of Mr. Thomas G. Corcoran, *Stock Exchange Practices, Hearings before the Senate Committee on Banking and Currency*, 73d Cong., 2d Sess., pt. 15 at 6557 (1934).

†See S. 2693, 73d Cong., 2d Sess. § 15(b)(3) (1934); H. R. 7852, 73d Cong., 2d Sess. § 15(b)(3) (1934).

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Webster's New International Dictionary (2d ed. 1954) defines a "rule of thumb" as "any rude process or operation, like that of using the thumb as a rule in measuring; hence, judgment and practical experience as distinguished from scientific knowledge", and The Shorter Oxford Dictionary (2d ed. 1936) speaks of it as a "roughly practical method".

Thus Section 16(b) set up an objective test for liability irrespective of actual use of inside information. If designated people did designated acts, they were to be held liable regardless of good faith, and regardless of actual ignorance of any inside information. The test adopted seemed simple and easy to understand—albeit intentionally crude and somewhat arbitrary. Yet by 1953, reflecting numerous decisions in lower Federal courts, the then Chairman and a then Special Counsel of the Commission could appropriately comment that Section 16(b) is "the most subtle and least understood" of the provisions of the Act.\*

The very pendency of this case demonstrates how far the actual interpretation of Section 16(b) by the lower courts, particularly the Second Circuit, has departed from the intent of Congress. The other briefs filed herein set forth specific questions for the Court's determination. The Society asks leave to file this brief because, in view of the express words of the statute and the clear Congressional intent, it is startling that such questions should even arise. They can arise only because, under the decisions of the lower courts, (1) *Section 16(b) has been applied without regard for economics or realities*, and (2) *no one can more than hazard a guess as to whom or to what transactions it may next be held to apply*. It is this appalling situation which undoubtedly has encouraged plaintiff to urge in this

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\*Cook and Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 386 (1953).

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suit a contention already decided squarely to the contrary in the *Rattner* case,\* one of the relatively few decisions which have recognized the clear Congressional intention that the Section be applied only to a specific and limited group of persons.

The Society strongly endorses the underlying purpose of Section 16(b)—to prevent the unfair use of inside information. In the 1920's there were some flagrant examples of such unfair use. Since that time, however, the evils at which Section 16(b) was directed have been almost eliminated by other factors.\*\*

Despite the existence of such other effective preventives, the courts, the Commission and various textwriters have vied with each other in distorting Section 16(b)—clear enough in its purpose and on its face—into a veritable man-trap. Such distortion might not seem so far beyond the pale in cases where actual unfair use of inside information was involved, bearing in mind the Congressional objective. However, although there have been more than 50 reported cases under Section 16(b), there has never been a finding in any of those cases that inside information was actually used. The findings of the trial court below make it clear that the instant case did not involve such use.

Furthermore, as the lower courts have recognized, Section 16(b) offers inviting opportunities for champerty. *E.g.*, *Magids v. Continental Can Co.*, 231 F. 2d 843 (2d Cir. 1956).

Section 16(b) was intended to be and is an arbitrary rule. Once it has been found that the purportedly objective

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\**Rattner v. Lehman*, 193 F. 2d 564 (2d Cir. 1952).

\*\*For example, high income tax rates on true short-swing transactions, the anti-fraud provisions of the Act and the Securities Act of 1933, vastly improved accounting standards, strengthened rules of the Stock Exchanges (particularly insistence on prompt publicity of corporate developments), the establishment of The National Association of Securities Dealers, Inc., and the prevalence of better corporate reporting.



*Motion*

standards it sets forth have been met, recovery follows inexorably, regardless of the defendant's good faith or the absence of actual use of inside information. Moreover, as applied by the lower courts, the penalty it imposes has often proved to be extremely drastic—much more so, we believe, than Congress intended. We think the Section *should* be used and strictly enforced for the purposes for which it was intended. But it is not fair or justifiable to apply such a statute except as a "crude rule of thumb". We think it has far too often been construed backwards—starting out with the conclusion and working back to an "interpretation" of the simple words used. That method does violence to the traditional canon of construction which calls for the strict interpretation of statutes which impose a penalty. See, *e.g.*, *Commissioner v. Acker*, 361 U.S. 87 (1959).

The parties herein are properly concerned with establishing their positions on the facts of the case. The Society, however, respectfully requests that the Court, in considering the specific issues in the case, also give consideration to the broader aspects of the problem. The attached brief is submitted in the hope that it will assist the Court so to do.

Respectfully submitted,

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September 18, 1961

**BRIEF OF AMERICAN SOCIETY OF CORPORATE  
SECRETARIES, INC., AS AMICUS CURIAE**

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**INTEREST OF *AMICUS CURIAE***

The interest of American Society of Corporate Secretaries, Inc., as *amicus curiae* is set forth in the Society's motion for leave to file this brief *amicus*, to which motion this brief is annexed.

**SUMMARY OF ARGUMENT**

Section 16(b) of the Securities Exchange Act of 1934 was designed by Congress to establish objective criteria for the liability of an insider for short-swing profits, without regard to the insider's good faith or the absence of actual use of inside information. The Section 16(b) remedy as applied by the lower Federal courts has gone far beyond the intent of Congress and with extremely drastic consequences. In addition, the decisions of the lower courts

have turned the Section into an open invitation to champertous lawsuits, without the usual procedural safeguards for stockholder actions.

In previous decisions of the lower courts, application of Section 16(b) has often been stretched so far beyond the intent of Congress that in many situations it is now unclear to whom the Section applies and what transactions it covers. One of the relatively few cases in which the lower courts have properly recognized the Congressional intent that the Section be applied only to a specific, limited class of persons is the *Rattner* case, in which, in circumstances indistinguishable from those obtaining here, the Second Circuit held almost ten years ago that the Section did not cover partners of insiders. Petitioner nevertheless would compound the already confused state of the law, asking this court to reject the well-established *Rattner* rule and to hold that not only those expressly designated by the Section are covered thereby, but also other persons whom Congress explicitly decided should not be covered. Petitioner alternatively urges this Court to rule that a person covered by the Section is liable not only for short-swing profits "realized by him", as provided by the Section, but also for profits realized by his partners.

The Section 16(b) remedy should be strictly limited to the transactions and persons expressly designated therein.

### ARGUMENT

#### **I. THE INHERENT HARSHNESS OF SECTION 16(b) HAS BEEN ACCENTUATED BY THE LOWER COURTS.**

The Congressional purpose in adopting Section 16(b)\* of the Securities Exchange Act of 1934\*\* was to prevent insiders from making unfair use of inside information. To accomplish that purpose Congress chose to adopt an objec-

\*48 Stat. 896 (1934), 15 U. S. C. § 78p(b) (1958).

\*\*48 Stat. 881 (1934), 15 U. S. C. § 78 (1958).



tive test for liability of an insider for short-swing profits irrespective of his good faith and without any proof of actual use or misuse of inside information.\* Section 16(b) is not unlike a highway speed limit in that regard. Once the criteria of the objective test have been met, liability of the insider follows inexorably, whether or not, under the particular circumstances of the case, such liability would serve the legislative purpose. As\* Petitioner has so candidly observed, "it is quite clear that the statute is wholly unconcerned with either the fairness of a particular transaction or the 'insider's' good faith or good intentions in effecting it". Petitioner's brief, p. 18.

The remedy which Congress adopted was simply recovery by the corporation of any short-swing profits realized by an insider.

"The objective was not to punish but to deter the persons in these three categories—directors, officers, 10% beneficial owners—from making improper use of information gained in a representative capacity. The practices could not be prevented *in toto* but Congress sought to take the profit out of what it considered improper conduct." *Adler v. Klawans*, 267 F. 2d 840, 844 (2d Cir. 1959).

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\*Framing a statute to prevent the unfair use of inside information for profit presented certain obvious problems of proof. For that reason Congress adopted an *objective* test for liability under Section 16(b) which does not require the plaintiff to prove actual unfair use of such information. Conversely, the test adopted, although covering many circumstances where such unfair use might occur, does not cover all such circumstances. Thus, for example, under Section 16(b) a transaction based on the unfair use of inside information does not create a right to recovery of profits realized unless it can be paired with another transaction to form a purchase and sale, or a sale and purchase, of the equity security involved. Similarly, Section 16(b) does not create liability where the purchase and sale based on inside information have not occurred within six months of each other. And it is also true that the Act does not provide recovery from a person not an insider who nevertheless profits from inside information. See 2 Loss, *SECURITIES REGULATION* 1042-43 (2d ed. 1961); Cole, *Insiders' Liabilities under the Securities Exchange Act of 1934*, 12 Sw. L. J. 147, 150 n. 22 (1958).

Nevertheless, the application of the Section's remedy has resulted in the imposition of extraordinary penalties.

The first case to arise under Section 16(b), *Smolowe v. Delendo Corp.*, 136 F. 2d 231 (2d Cir.), *cert. denied*, 320 U. S. 751 (1943), presented the problem of computing Section 16(b) profits where there had been multiple purchases and sales of securities within a six-month period. After stating that Section 16(b) was designed "to squeeze all possible profits out of stock transactions", 136 F. 2d at 239, the court rejected all usual accounting methods, such as matching stock certificates, the "first-in, first-out" method and average cost. The court instead established a rule that profits should be calculated by matching purchases of securities at the lowest price with sales at the highest, thereby achieving the greatest possible recovery for the corporation.

The application of such a rule may result in the recovery of "profits" under Section 16(b) even where the insider has actually suffered a loss during the six-month period. Exactly that situation arose in *Gratz v. Claughton*, 187 F. 2d 46 (2d Cir.), *cert. denied*, 341 U. S. 920 (1951), where the defendant was held liable for more than \$300,000 in "profits" notwithstanding the fact that the net result of his transactions was a *loss* in excess of \$300,000.\* Clearly, the insider in that case made poor use of his inside information, if any he had.

To illustrate the prevailing rule of damages under Section 16(b):

(1) First a simple example. An insider (a) buys a share at \$20, (b) the next day sells it at \$19, (c) buys another share five months later at \$10 and (d) the following day sells it at \$9. In fact, he is out-of-pocket \$2. As Section 16(b) has been applied, however, he has

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\*See *Adler v. Klawans*, 267 F. 2d 840, 847-48 (2d Cir. 1959).

sold a share at \$19 and bought another share at \$10, and has therefore made a recoverable "profit" of \$9! No offset whatsoever is allowed for the \$11 loss which results from matching the other two transactions within the six-month period (the \$20 purchase and the \$9 sale).

(2) Examine then a more complex case. An insider, at the beginning of 1961, owned 2,000 shares of his company's stock which he bought in 1947 at \$10 a share. He makes the following transactions:

<u>Date</u>	<u>Transaction</u>	<u>No. of Shares</u>	<u>Price</u>	<u>Cost</u>	<u>Proceeds</u>
1/3/61	Purchase	400	\$30	\$12,000	\$ ....
2/1/61	Purchase	800	48	38,400	.....
3/1/61	Sale	500	50	....	25,000
6/30/61	Sale	700	20	....	14,000

He thus ends up with 2,000 shares, the same number that he started with. The cost of the shares that he bought in 1961 was \$50,400. The proceeds received from the sale of the shares in 1961 was \$39,000, giving him an actual loss of \$11,400 on the transactions within the six-month period (disregarding the probability that he will pay long-term capital gains taxes on the sale of some of the shares previously held).

Now apply the Section 16(b) rule of damages:

(i) the purchase of 400 shares on January 3 at \$30 would be matched against the sale of 400 of the 500 shares sold March 1 at \$50, showing a "profit" of \$8,000; and

(ii) the purchase of 100 of the 800 shares bought February 1 at \$48 would be matched against the sale of the remaining 100 shares of the 500 shares sold March 1 at \$50, creating a recoverable "profit" of \$200,

or a total recoverable profit of \$8,200.

Note that there are no transactions against which to match, at a "profit", the sale of 700 shares on June 30 at

\$20 or the purchase of 700 of the 800 shares bought at \$48 on February 1, so they are disregarded in the computation.

To summarize, the insider who has actually lost \$11,400 (before paying his taxes) also owes \$8,200 to his company under Section 16(b).

The harshness of the Section 16(b) remedy as imposed by the lower courts is all the more evident in light of the fact that Congress declined in 1934 to make short-term trading by insiders unlawful;\* that it was specifically represented to Congress that an insider was free to sell stock of his company within six months after purchasing it, the only consequence being that he would have to forego any profit;\*\* and that Congress specifically rejected any penalty provision.\*\*\*

The hazards for corporate insiders under Section 16(b) are compounded by the fact that the Section has been made an attractive instrument of champerty, readily available for harassment purposes even where the litigation is utterly without merit. The Act does not authorize the allowance of fees to the attorneys for successful Section 16(b) plaintiffs. But, in the *Smolowe* case, an attorney's fee was allowed and the Second Circuit, speaking through Judge Clark, stated that "since in many cases such as this the possibility of recovering attorney's fees will provide the sole stimulus for the enforcement of § 16(b), the allowance must not be too niggardly". 136 F. 2d at 241. Since that time the door has been opened wide. Contrary to the usual rules, the courts have held in applying Section 16(b) that the plain-

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\*See S. 2693, 73d Cong., 2d Sess. § 15(b) (1934); H. R. 7852, 73d Cong., 2d Sess. § 15(b) (1934).

\*\**Stock Exchange Practices, Hearings before Senate Committee on Banking and Currency*, 73d Cong., 2d Sess., pt. 15 at 6557 (1934).

\*\*\*See S. 2693, 73d Cong., 2d Sess. §§ 15(b), 24 (1934); H. R. 7852, 73d Cong., 2d Sess. §§ 15(b), 24 (1934).

tiff need not have been a stockholder at the time of the transactions of which he complains;\* that the plaintiff, even though he owns only a few shares bought after the event, need not put up security for costs of litigation;\*\* and that the bad faith of plaintiff is not a sufficient reason for denying recovery or even for denying fees to the attorney.\*\*\* Thus Judge Ryan has said,

"I have reluctantly come to the conclusion that the probable existence of such [champertous] conduct in these suits should not bar the attorney from receiving an allowance. . . .

". . . . Whatever the ethics of the situation, the purpose of the statute is thus fulfilled." *Magida v. Continental Can Co.*, 176 F. Supp. 781, 782-783 (S. D. N. Y.), aff'd, 231 F. 2d 843 (2d Cir.), cert. denied, 351 U. S. 972 (1956).

If such had been the intent of Congress, one wonders why it required that the plaintiff in a Section 16(b) case be a security holder at all.

The matters discussed above illustrate the reasons for the Society's concern with any extension of the Section to persons and transactions not contemplated by Congress—i.e., persons and transactions defined in any way other than in accordance with the plain words of the Section.

## **II. SECTION 16(b) SHOULD BE APPLIED ONLY TO OFFICERS, DIRECTORS AND 10% BENEFICIAL STOCKHOLDERS.**

This case involves a specific aspect of a problem in which the Society is vitally interested—to whom does

\**Magida v. Continental Can Co.*, 231 F. 2d 843 (2d Cir.), cert. denied, 351 U. S. 972 (1956); *Dottenheim v. Murchison*, 227 F. 2d 737 (5th Cir. 1955), cert. denied, 351 U. S. 919 (1956); *Benisch v. Cameron*, 81 F. Supp. 882 (S. D. N. Y. 1948).

\*\**Truncale v. Blumberg*, 80 F. Supp. 387 (S. D. N. Y. 1948).

\*\*\**Magida v. Continental Can Co.*, 231 F. 2d 843 (2d Cir.), cert. denied, 351 U. S. 972 (1956).



Section 16(b) apply? In light of the supposedly objective nature of the Section's test for liability and the harshness of its remedy, that problem should never arise. The express words of the statute define the persons covered by the Section in uncomplicated language. Such persons are "the beneficial owner of more than 10 per centum of any class of any equity security" of an issuer and "a director or an officer" of an issuer.\* Such persons, if they do the proscribed things, are liable regardless of good faith.

To be sure, the purpose of Section 16(b)—to prevent unfair use of inside information for profit—might have been extended to a wider class of persons. Congress might on the other hand have required actual proof of misuse of inside information. But Congress did neither. The original bills introduced in Congress provided for recovery of "any profit made by *any person*, to whom . . . unlawful disclosure [of any confidential information regarding or affecting any registered security] shall have been made . . . "\*\* (Emphasis supplied.) However, that provision was eliminated from the statute as finally enacted, "presumably ~~because~~ the burden of proof made enforcement unfeasible". *Smolowe v. Delendo Corp.*, 136 F. 2d 231, 236 (2d Cir.), *cert. denied*, 320 U. S. 751 (1943). On the other hand, Congress eliminated a requirement in the original bills that *actual* misuse of information be proved. Thus Congress, for obvious reasons, drew two arbitrary lines—(1) *only* 10% stockholders, directors and officers were to be covered and (2) they would be liable *without fault*. Petitioner here seeks to erase the first of those lines.

It is argued that Congress did not mean what it said, but that the Section should apply to the persons designated therein and also to others who may be in positions to acquire

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\*Section 16(a), 48 Stat. 896 (1934), 15 U. S. C. § 78p(a) (1958).

\*\*S. 2693, 73d Cong., 2d Sess. § 15(b)(3) (1934); H. R. 7852, 73d Cong., 2d Sess. § 15(b)(3) (1934).

inside information. Petitioner would not even limit the broadened application he urges to persons who actually use inside information unfairly, but would extend it to anyone who *might* use such information. On the facts of this case Petitioner must be saying that persons not covered by the Section are nevertheless liable, even when they did not use inside information. This goes some distance beyond the original bills which Congress rejected.

Section 3(a)(7) of the Act\* defines "director" as "any director of a corporation" (thus obviously equating the term with its well known meaning in corporation law and in business and legal parlance) and in addition "any person performing similar functions with respect to any organization, whether incorporated or unincorporated". It would thus seem clear without more that Congress did not intend the Section to apply to partners of directors.

The present litigation was instituted despite the fact that it was squarely held almost ten years ago that no Section 16(b) liability exists in the circumstances of this case. In 1952, the Court of Appeals for the Second Circuit held in *Rattner v. Lehman*, 193 F. 2d 564 (2d Cir. 1952), that the term "director" as used in the Act did not encompass the partners of a director. The *Rattner* decision, one of the relatively few by the lower courts which have properly recognized the clear intent of Congress to restrict Section 16(b) applicability to a specific and limited group of persons, has never been questioned by any court, nor by the Commission prior to the inception of this case, and has, beyond all doubt, been widely relied upon by the business community.

Petitioner's hope that by bringing this suit he might obtain reversal of that well-established rule apparently has its genesis in the fact that, notwithstanding the clear statutory delineation of the persons to whom Section 16(b) ap-

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\*48 Stat. 883 (1934), 15 U. S. C. § 78c(a)(7) (1958).



plies, interpretations of the Section by the lower courts have often strayed far beyond that limit. Although the Section provides for recovery of "any profit realized by [an insider] . . . from any purchase and sale, or any sale and purchase, of any equity security", the Second Circuit has stated that a person may be liable "who was a director, officer or beneficial owner *at some time*", but not necessarily at the time of both the purchase and the sale. *Adler v. Klawans*, 267 F. 2d 840, 844 (2d Cir. 1959). Such a result is surprising enough in the case of an officer or a director since the statute expressly refers to *pairs* of transactions by insiders (i.e., "any purchase *and* sale" or "any sale *and* purchase"), and it would seem to be expressly prohibited by Section 16(b) in the case of a 10% stockholder. Section 16(b) provides "[t]his subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved".\* Nevertheless, the Second Circuit, speaking through Judge Clark, in the face of that express statutory language, has held that the purchase by which a person became a 10% stockholder may be used as a basis for liability, ignoring the fact that the stockholder did not even become an insider (and hence did not even presumptively obtain access to confidential information) until *after* he had acquired a 10% interest. *Stella v. Graham-Paige Motors Corp.*, 232 F. 2d 299 (2d Cir.), *cert. denied*, 352 U. S. 831 (1956). *But see Arkansas La. Gas Co. v. W. R. Stephens Inv. Co.*, 141 F. Supp. 841 (W. D. Ark. 1956).

In *Colby v. Klune*, 178 F. 2d 872 (2d Cir. 1949), the Second Circuit, through Judge Frank, said, by way of dictum, that if it were not for the Commission's Rule 3b-2 (see below) it would "construe" the word "officer" as used in Section 16(b) to include

"a corporate employee performing important executive duties of such character that he would be likely,

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\*48 Stat. 896 (1934), 15 U. S. C. 78p(b) (1958).

in discharging these duties, to obtain confidential information about the company's affairs that would aid him if he engaged in personal market transactions". 178 F. 2d at 873.

That revealing dictum clearly has no relation to the word "officer" as it is understood and used in the business community and, presumably, by Congress.

It is also contrary to the SEC's published rules. Since 1934 one of the Commission's rules has defined "officer" as "a president, vice-president, treasurer, secretary, comptroller, and any other person who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers".\* The Commission's General Counsel has indicated that "any other person" includes an officer's assistant whose "chief is so inactive that the assistant is really performing his chief's functions".\*\* While this slight extension of the words of the rule may perhaps be justifiable, no further extension is warranted.

Fortunately, the *Colby* dictum has not been adopted by anyone. In fact, it has been rejected by other courts (*Lockheed Aircraft Corp. v. Campbell*, 110 F. Supp. 282 (S. D. Cal. 1953); *Lockheed Aircraft Corp. v. Rathman*, 106 F. Supp. 810 (S. D. Cal. 1952)) and by the Commission (Securities Exchange Act Release No. 4754 (Sept. 24, 1952), 17 Fed. Reg. 8900-2 (1952)). But the possibility that such a "method" of statutory construction might prevail—this time in connection with the definition of "director"—is of direct concern to the Society.

The Court for these compelling reasons alone should make clear once and for all that "director" means "director", that "officer" means "officer", and that "10% stockholder" means just that. Such is the essence of this case.

\*SEC Rule 3b-2, 17 C. F. R. § 240.3b-2 (1949).

\*\*Securities Exchange Act Release No. 2687 (Nov. 16, 1940), 11 Fed. Reg. 10981-2 (1946).

**III. THE UNDULY BROAD CONSTRUCTION BY THE LOWER COURTS OF THE TERMS "PURCHASE" AND "SALE" UNDER SECTION 16(b) REQUIRES THAT THE SECTION BE APPLIED ONLY TO THOSE PERSONS EXPRESSLY DESIGNATED BY THE STATUTE.**

It would seem that the lower courts, in view of the inherent harshness of Section 16(b) and its applicability regardless of actual fault, would have been quick to recognize the importance of restricting its application to transactions clearly specified by Congress. Quite to the contrary. Violence has also been done by the lower courts to the statutory designation of transactions covered by Section 16(b). Those transactions are "any purchase and sale, or any sale and purchase," of an equity security within six months. The unwarranted judicial expansion of those terms—plus even further expansion advocated by some legal writers—has made Section 16(b) even more fraught with peril. It is thus evident how important it is to the Society and the business community that the Court hold here that the Section should be confined to the persons whom Congress explicitly specified the Section was to cover.

One aspect of that problem, although not presented for determination by this Court, was raised on the cross-appeal below—was the conversion by Lehman Brothers of its Tide Water common stock into shares of a new issue of preferred a "purchase" of that preferred under Section 16(b)?

The words "purchase" and "sale" have commonly accepted meanings. In addition, the Act itself defines them to include contracts of purchase and sale.\* But the words "purchase" and "sale" and "contract" have also been contorted to cover transactions never intended by Congress. It

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\*Section 3(a)(13), 48 Stat. 884 (1934), 15 U. S. C. § 78c(a)(13) (1938).

is obvious, of course, that a certain flexibility in the application of Section 16(b) is necessary in order to prevent evasion of its terms. In actual practice, however, the Section has been applied not to cases of evasion, but virtually to any situation in which an insider *could* have used inside information to make a profit, even though he did not actually do so. Thus, conversion of a convertible security into common stock, even after a call for redemption, has been held a "purchase" of the common stock. *Park & Tilford, Inc. v. Schulte*, 160 F. 984 (2d Cir.), *cert. denied*, 332 U. S. 761 (1947). *Contra, Ferraiolo v. Newman*, 259 F. 2d 342 (6th Cir. 1958), *cert. denied*, 359 U. S. 927 (1959). It has been suggested that such conversion may also be a sale of the convertible security.\*

The *Schulte* case and the further suggestion of the law review writers fly in the face of the fact that the insider has exactly the same number of dollars invested in his company both before and after the conversion.

It has even been suggested that the insiders of a corporation which acquires another corporation by merger or acquisition of assets may unwittingly have sold their stock in the original corporation and simultaneously bought it back, even though the stock certificates never left their safe deposit boxes. Memorandum for the Commission as *Amicus Curiae*, pp. 7-11, *Blau v. Hodgkinson*, 100 F. Supp. 361 (S. D. N. Y. 1951). Moreover, a transfer by a corporation to its own majority-owned subsidiary of shares of a third company in exchange for additional shares of the subsidiary has been held a "sale", even though the court recognized that the parent corporation ended up with the same proportionate interest in the third company, and thus remained in exactly the same economic position as it had been

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\*Cook and Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 612, 624 (1953).

in before the transfer. *Blau v. Mission Corp.*, 212 F. 2d 77 (2d Cir.), *cert. denied*, 347 U. S. 1016 (1954).

Simple transactions may have incredibly far-reaching consequences. It has been suggested that the sale of a convertible security should be considered, for Section 16(b) purposes, a sale of the underlying common stock.\* The court in *Truncale v. Blumberg*, 80 F. Supp. 387 (S. D. N. Y. 1948), indicated that the execution of an employment contract providing for the annual issuance to an employee of 5,000 warrants was a "purchase" of such warrants, relying on the statutory definition of "purchase" as including a "contract to . . . otherwise acquire"\*\*\* the warrants. It was also suggested that the subsequent issuance each year of the 5,000 warrants was also a "purchase". 80 F. Supp. at 392. Thus, each year's issue of warrants was "purchased" by the employee twice—once on the execution of the contract and once on the date of issuance. Moreover, it has been argued that if a company grants an employee a stock option exercisable one year after grant and which is actually exercised two years after grant, the employee may have "purchased" the *stock*, for Section 16(b) purposes, on three dates—the date of option grant, the date it becomes exercisable and the date of exercise.\*\*\* All this despite the fact that it is perfectly clear that an option to acquire shares is neither the acquisition of those shares nor a contract to do so—it is merely a right exercisable at the optionee's discretion, not a contract obligation binding him to do anything. To compound the confusion, it is said that the employee may have "purchased" the *option* twice, i.e., on the date of grant and on the date it becomes exercisable and

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\*Rubin and Feldman, *Statutory Inhibitions upon Unfair Use of Corporate Information by Insiders*, 95 U. Pa. L. Rev. 468, 486 (1947).

\*\*Section 3(a)(13), 48 Stat. 884 (1958), 15 U. S. C. § 78c(a) (13) (1958).

\*\*\*Cook and Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 612, 619-620 (1953).

that such "purchase" of the option may be matched with a sale of actual securities of the same class covered thereby.\* And the ultimate absurdity—it has been contended that a *gift of stock to a charity* may be a Section 16(b) *sale* which, if matched with a purchase, may create liability.\*\* The donor may have realized a profit, so the argument goes, wholly aside from any tax implications, "in the form of prestige and community standing" or in the establishment of "a reputation for financial responsibility and business success".\*\*\*

There are cases, of course, in which courts have found an absence of a Section 16(b) "purchase" or "sale". The decisions in certain of those cases, however, indicate that the court's determination was based not on a decision as to whether or not the transaction was a purchase or sale, but rather on whether or not the court could find any way in which the insider could profit from inside information. See *Shaw v. Dreyfus*, 172 F. 2d 140 (2d Cir.), *cert. denied*, 337 U. S. 907 (1949); *Roberts v. Eaton*, 212 F. 2d 82 (2d Cir.), *cert. denied*, 348 U. S. 827 (1954). As the Queen of Hearts said, "Sentence first—verdict afterwards."† Under that kind of reasoning, the hazards for a corporate insider are almost without limit. As the then General Counsel and a then Attorney of the Commission recently wrote,

"... [I]t seems clear that in the Second Circuit even a transaction which does not result in change in the insider's proportionate interest may possibly be a purchase or sale within section 16(b)... Splits, stock dividends, reclassifications, and similar corpo-

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\**Ibid.*

\*\*Comment, *The Scope of "Purchase and Sale" under Section 16(b) of the Exchange Act*, 59 Yale L. J. 510, 528-530 (1950).

\*\*\**Id.* at 528.

†CARROLL, *ALICE'S ADVENTURES IN WONDERLAND* 199 (Caldwell ed.).



rate devices are readily susceptible to such abusive manipulation",\*

and therefore, presumably, within the reach of Section 16(b).

The risk of unwarranted application of Section 16(b) to transactions which could only by the most imaginative persons be called "purchases" or "sales" leads to startling consequences. Consider, for example, a corporation with outstanding convertible preferred stock, common stock and an option plan. There are 24 possible combinations of transactions, most of them obscure, concerning which an insider must consider the implications of Section 16(b).\*\*

The very possibility that liability might be found by the lower courts to exist by reason of such constructions of the simple words "sale" and "purchase" should impel the Court, at the very least, to define as strictly as Congress did the persons to whom Section 16(b) applies.

#### **IV. THE SECTION 16(b) REMEDY AGAINST AN INSIDER SHOULD BE RESTRICTED TO PROFITS ACTUALLY "REALIZED BY HIM."**

Respondent Thomas, in the present case, *did not receive a penny* of the profits realized on the short-swing transactions which are the subject of the litigation. Respondents argued below that Thomas, for that reason, should not be liable for any of those profits. The courts below, however, agreed with Petitioner that Thomas' anticipatory waiver of his right to receive a share of those

\*Meeker and Cooney, *The Problem of Definition in Determining Insider Liabilities under Section 16(b)*, 45 Va. L. Rev. 949, 978 (1959).

\*\*Possible purchases: grant of option, accrual of right to exercise option, exercise of option, purchase of preferred, conversion of preferred, purchase of common. Possible sales: exercise of option, conversion of preferred, sale of preferred, sale of common.



profits, if any should be realized, was ineffective to avoid Section 16(b) liability.

That issue is not presently before this Court. Petitioner does contend, however, as he did below and as his attorney did in the *Rattner* case,\* that a director of a corporation should be liable for the entire amount of the profits realized by his non-insider partners. Such a contention is contrary to the plain meaning of the words of Section 16(b), which expressly provides for recovery from a director of "any profit realized by him".\*\* (Emphasis supplied.) It also conveniently overlooks the fact, as pointed out above, that Congress rejected the proposal to make Section 16(b) apply to other persons. Furthermore, that proposition was squarely rejected in the *Rattner* case.

A member's interest in the profits earned by his partners is, before distribution, undivided but not indivisible—and the amount of such interest is limited to his specific share as provided by the partnership agreement. See *N. Y. Partnership Law*, § 52. Under no circumstances may he succeed to the complete ownership of these profits; any attempt by him to do so would be unlawful. The trial court clearly stated the nature of Thomas' interest in the profits realized by Lehman Brothers from their transactions in Tide Water stock. Had Thomas not waived his right to receive those profits, he would have been entitled to receive approximately 4% of such profits.

Nor did Thomas have anything whatsoever to do with the creation of the profits, either directly or indirectly. The trial court found as a fact that Thomas had not caused Lehman Brothers to make the transactions in Tide Water securities. It specifically found that the firm's decision to do so had been based on two articles which appeared in

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\**Rattner v. Lehman*, 193 F. 2d 564 (2d Cir. 1952), the only other Section 16(b) case regarding short-swing profits realized by non-insider partners of an insider.

\*\*48 Stat. 896 (1934), 15 U. S. C. § 78p(b) (1958).

The Wall Street Journal. Everything would have happened in exactly the same way even if Thomas had been on an extended vacation throughout the entire period.

Petitioner and the Commission seek to support the proposition that an insider is liable for all profits in which he has an undivided interest, even if that interest is shared with another, citing only *Walet v. Jefferson Lake Sulphur Co.*, 202 F. 2d 433 (5th Cir.), *cert. denied*, 346 U. S. 820 (1953). That case, however, is inapposite because the undivided interest there was the community property of husband and wife in a community property state. The court there pointed out that under the law of Louisiana the husband "is the head and master of the community and as such must be held accountable for his management thereof to the same extent as if it were his own". 202 F. 2d at 434. That reasoning is certainly not appropriate in the case of a 4% partner, who obviously has no right or power to direct the affairs of the partnership. Moreover, under Louisiana law recovery of less than the entire Section 16(b) profit would have left to the husband in *Walet* an undivided half interest in the portion of that profit remaining in the community—a result which does not obtain here.

The Commission's brief states that "if recovery were limited to the portion of the profit applicable to the partner-director, as the court below held, an investment banking firm with 20 equal partners, no two of whom were officers or directors of the same corporation, could use inside information in short-swing trading *ad infinitum* and never have to disgorge more than five per cent of its profits". Commission's brief p. 11. What the Commission has overlooked, however, is what Congress said. It is self-evident that there are many close relationships among members of a community (whether of a business or a social nature) in which the opportunity for exchange of inside information is present. Clearly the operative language of Section 16(b)

does not apply to persons in a position to obtain inside information by such contacts if they are not otherwise insiders. There is no justification under the Section for singling out partnerships for different treatment.

# **CONCLUSION**

Because of the drastic nature of the Section 16(b) remedy, it is incumbent upon the courts to limit its applicability to those specific persons and transactions which Congress clearly intended to cover.

The judgment of the District Court should therefore be affirmed.

Respectfully submitted,

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**September 18, 1961**

**Certification**

I, Bruce Bromley, one of the attorneys for American Society of Corporate Secretaries, Inc., *amicus* herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that on the 18th day of September, 1961, I served copies of the foregoing Motion for Leave to File and the annexed Brief *Amicus* in the captioned cause by causing to be mailed a copy thereof with first class or air mail postage prepaid (as appropriate) as follows:

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